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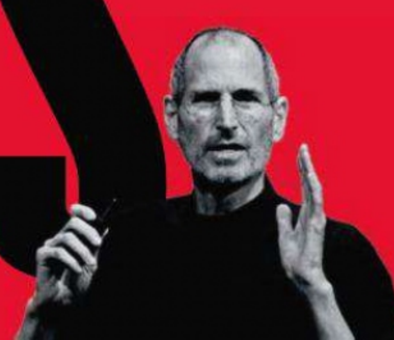
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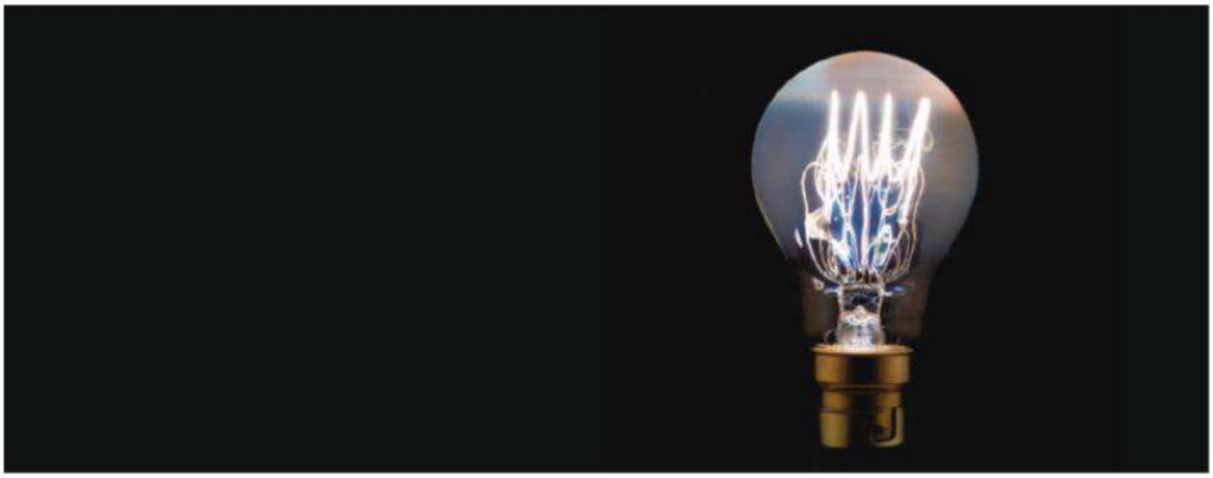
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APPLE WITHOUT JOBS



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Until he perfected the invention that would change everything, Thomas Edison would not rest.



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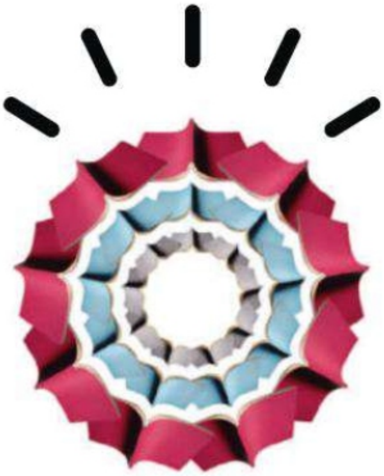
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Gramo A/S is rewriting the book on energy solutions.

By implementing an intelligent energy management system, this midsize bookbindery in Denmark created its own virtual power plant that controls consumption and cut costs by 10%.



Rosenau is steering its fleet toward happier customers.

This midsize transport company in Canada implemented onboard tracking technology to help optimize delivery routes and provide clients with up-to-the-minute shipping alerts.

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GSMS is protecting products and patients.

Using track-and-trace technology, this midsize pharmaceutical manufacturer and specialty packaging company in California is helping keep counterfeits out of its supply chain.



Dragon Hotel is providing a legendary guest experience.

At the heart of this Chinese hotel is a dynamic IT infrastructure that uses RFID-equipped smart cards for fast check-ins and custom room preferences so guests feel right at home.

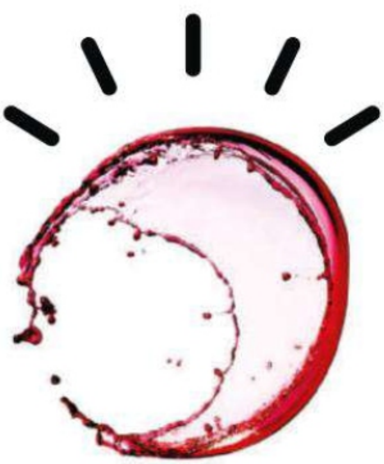
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Gruppo Intergea is accelerating its data security.

This Italian midsize business has been able to improve infrastructure security in car dealerships, showrooms and repair shops by identifying new threats and staying ahead of them.



Wine Warehouse is improving the flow of information.

Trying to keep ahead of growth, this midsize wholesale distribution company integrated its finance, order-entry and pricing systems—improving inventory efficiency and order accuracy while maximizing profits.

Feedback

Knocking the Glock

Rarely have I seen a Cover Story in your publication as sensationalist and offensive as "The Killing Machine" (Features, Jan. 17-23). If you wished to speak out on behalf of limited-capacity magazines, you could have done so in a far more compelling manner than by first demonizing an entire company, and by implication the tens of thousands of legal Glock owners in this country.

You have chosen to communicate the wrong message at the wrong time, and in the wrong way.
Manny Contomanolis
Rochester, N.Y.

Thanks for that article. It's very informative and well written. It would sure be nice if someone would write a piece on the impact on crime of concealed-weapons permit laws. I'm told that is a significant factor in the reduction of homicides.
Mark Kraschel
via e-mail

The Second Amendment of the U.S. Constitution states: "A well regulated militia, being necessary to the security of a free State, the right of the people to keep and bear Arms, shall not be infringed." Obviously the need for a state militia has been replaced by the National Guard and U.S. Coast Guard, whereby trained military personnel are entrusted with the defense of this country against domestic enemies. Their weapons are tightly controlled and safeguarded.

The only two reasons for a citizen to own a firearm are for hunting or defense of the household from intruders. In either case, ownership of a handgun, shotgun, or rifle is more than adequate. There is absolutely no need for any U.S. civilian to own any weapon more powerful or sophisticated than these. Accordingly, all handguns, shotguns, and rifles must be licensed and registered to the degree necessary to match weapon to owner at the click of a computer key. Furthermore, if we had prohibited the purchase of more sophisticated weapons (i.e., a Glock-19 semiautomatic pistol with an extended magazine), several innocent victims would not have died or been harmed.

The shooter is obviously disturbed by mental illness. It appears that those defending the right to own sophisticated weapons exhibit the same qualities by showing a callous disregard for the safety and protection of their fellow citizens. Mental illness and guns are as bad a combination as alcohol and driving. Evidently we have the money to fight two wars overseas, but not the political will to treat the mentally ill, who are a danger not only to themselves, but to everyone else.
Joe Bialek
Cleveland

The shooting in Tucson was premeditated by a person with a screw loose. We are humans, and humans are prone to sudden and violent rages as all natural controls cease. We are capable of many things, even killing loved ones. Restraining the use of handheld firearms, especially those classified as assault weapons or those that can carry more than eight or nine rounds of ammunition, must be controlled in such a way that the carrier cannot readily kill someone in less than 15 seconds, during which time reason should take over and the rage subside.
Randall J. Marlowe
Buenos Aires

Would you have gone after General Motors so adamantly if a Chevy truck had been driven into the crowd, or Louisville Slugger if a bat had been used, or Gerber if a knife had been used?

Probably not. The Glock is a fine weapon and operates under extreme conditions, as do the similar pistols made by Smith & Wesson, Springfield Armory, Sturm Ruger & Co., and many others. While the situations that arise are very unfortunate, it still boils down to the instability of the person that somehow had that weapon. Aren't the lawful background checks supposed to impede people like this from owning weapons?
Brian Harruff
Fort Wayne, Ind.

I'm disappointed by the unbalanced antigun tone of Paul M. Barrett's story. There were plenty of shooting incidents

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mentioned, but only one police use of the weapon. Conspicuously absent were stories of civilian defensive use of the Glock and other firearms. And regarding the horrible Killeen Massacre in 1991, the author failed to mention that one of the survivors, Susanna Gratia Hupp, became a lawmaker and pushed the Texas legislature to allow concealed carry in that state, despite having lost her parents [to firearms].

There was a far better story about Glock pistols in this same magazine not too long ago. "The Killing Machine" was clearly intended as a hit piece.
Aaron Woodin
White Plains, N.Y.
(Editor's Note: The "far better story" was also written by Paul M. Barrett.)

Far from being an enlightened article, "The Killing Machine" seems to say that the scary boogeyman gun is the problem, as opposed to the scary boogeyman behind the trigger.

I also like the cute reference to "Second Amendment enthusiasts," like we are some sort of club. I have not seen any similar reference to "First Amendment enthusiasts" for those people that believe in other freedoms.
Scott Carlson
Geneva, Ill.

Teacher's Pettiness

I read Randi Weingarten's comments in *The New York Times* last December, where she complained that South Korea, Finland, Singapore, and Taiwan, I believe, have strong unions, and their schools are strong and have high levels of education and results. She said this, but I don't know if she is correct. She was trying to legitimize her union, the American Federation of Teachers. One thing I do know is that Asian and European societies have education levels that are so much higher than in the U.S.

I also read her comments in *Bloomberg Businessweek* (Etc., Hard Choices, Jan. 17-23). First, I think Weingarten is full of red ants. She questions capitalism. Well, she merely confirms that labor unions are steeped in Marxist theology. Also, is she proud of the urban schools she represents? A 50 percent dropout rate in Philly? Almost the same in Chicago and Baltimore? What does she think of the "rubber rooms" for teachers in New York City? If a teacher doesn't kiss the behind of an administrator, they get sent to a rubber room.

Finally, the photograph of Weingarten is funny. She is not noble. She is a loudmouth. I have seen her on David Gregory's show on Sunday, and she embodies those qualities. Why not have a halo around her?
Name withheld
Philadelphia

Bloomberg Businessweek provided a good service to its readers by publishing the interview with Randi Weingarten. What we learn from it is that what matters in education is teachers' "inputs," which can only mean that teachers are to be judged by how much effort they are making. "Output"–that is, the level of student achievement–seems not to be relevant in Weingarten's view.
Ronald K. Smeltzer
Princeton, N.J.

Corrections & Clarifications

"If Demography Is Destiny, Then India Has the Edge" (Global Economics, Jan. 17-23) incorrectly stated that HSBC and Standard Chartered predicted India's growth would exceed China's in per capita and overall terms. The banks predicted that India would eventually exceed China's overall growth rate, but not growth per capita.

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Sun World is harvesting new insights.

Specializing in the growing, packing and shipping of fresh produce, this midsize business in California is using IBM Cognos business analytics solutions to analyze operations data and improve harvesting efficiency.



Let's build a smarter planet.

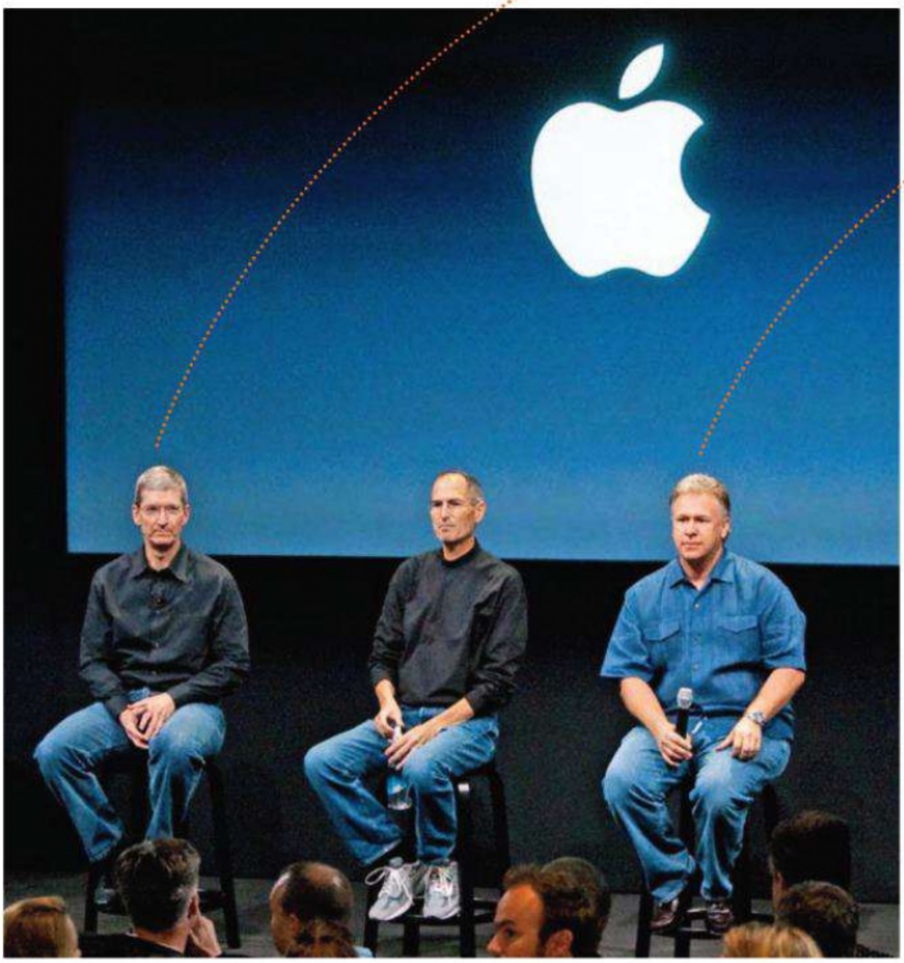
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Opening Remarks

The Essence of Apple

The company will prosper even if Steve Jobs doesn't return. Keeping the revolutionary edge will be harder. By Brad Stone and Peter Burrows


KIMBERLY WHITE/CORBIS

IPods, iPads, and iPhones would have baffled the German social scientist Max Weber, who died in 1920. The father of modern sociology, however, would surely have understood something about the man behind those futuristic gadgets. Weber defined the "charismatic leader" as one whose influence stems from almost preternatural insights and imagination, and who inspires devotional loyalty from his followers—which adds up to an uncanny description of Steve Jobs.

Weber also argued that organizations structured around a charismatic leader are doomed to lose their vigor after the great one leaves the scene. That prediction became relevant on Jan. 17, when Jobs, perhaps the most charismatic chief executive officer in business history, announced yet another medical leave from Apple, the company he has led to breathtaking heights. In a letter to his 50,000 employees, Jobs handed off daily control of the company to Apple's chief operating officer, Timothy D. Cook. He didn't say when he would return or why he was leaving, but the undertones were ominous. He referred to his management team's plans for 2011 and sounded an unusual emotional note: "I love Apple so much and hope to be back as soon as I can."

The announcement triggered speculation about Jobs' health—and minor indigestion among shareholders. It also posed yet again the unavoidable question that now looms over 35-year-old Apple: What happens to a modern company whose innovations and inspirations are so closely tied to the vision of one leader when that leader's influence is in decline? The only thing certain is that the Apple of the future—whether in a year or a decade—will look a lot different from the reliable engine of innovation and profits that investors and customers know so well.

Jobs' health has been an issue for so long that many investors have grown inured to it. In 2004 doctors diagnosed Apple's co-founder with a neuroendocrine tumor, a rare form of pancreatic cancer. He took an undisclosed leave of absence for treatment and a six-month leave in 2009, when he underwent a liver transplant at the Methodist University Hospital Transplant Institute in Memphis.

Apple spokesperson Katie Cotton declined to comment further on Jobs' condition. According to a person with direct knowledge of his health, who requested anonymity because the matter is private, the Apple founder has had trouble gaining weight, and immunosuppressant medications related to the transplant have made him susceptible to colds and the flu.

Jobs' health problems have not interrupted Apple's historic run of successes. Apple devices and online services such as iTunes have, one by one, disrupted the music, mobile phone, media, and videogame industries. Even the Macintosh is on a tear. It now commands 9.7 percent of the personal computer market in the U.S., up from less than 3 percent a decade ago. Along the way, Apple has become the second most highly valued company in the world, behind only ExxonMobil and well ahead of tech nemesis Microsoft. On Jan. 19, Apple announced its latest results: $6 billion in profits during the last three months of 2010, a record that surpassed the previous high by 40 percent.

With all that momentum, Apple can thrive for years, even without Jobs' daily presence. The company's lineup for 2011

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COO Cook runs everything from production to customer service

Marketing guru Schiller has handled keynotes in Jobs' absence

is set. It includes the iPhone for Verizon and, in all likelihood, new versions of the iPhone and iPad as well as fresh takes on old hits like the iPod and iMac.

Plans are no doubt taking shape for 2012 and beyond. Jobs recently revealed that the company was working on the iPad even before the debut of the iPhone in 2007. Similarly, the Apple skunkworks has probably cooked up new versions of the iPhone and iPad for next-generation 4G mobile networks. Some analysts even believe Apple could be preparing its own high-definition television, with Apple TV software built in, as an alternative to the lightly selling $99 Apple TV set-top box. "They know what products they are launching at least two years, and maybe even three or more, into the future," says Barclays Capital analyst Ben Reitzes. "They are on autopilot to a degree, at least in terms of the big picture."

Although the product plan may be mapped, Apple without Steve Jobs will be a less interesting company. Jobs, according to the portrait laid out in countless biographies and articles over the years, is a control freak with a compulsive attention to detail. He routinely sends products back to the lab, kills them in their crib, demands new features, or euthanizes old ones, all while keeping Apple's attention narrowly focused on just a few products with potential for high returns. "We're always thinking about new markets we could enter," Jobs told *BusinessWeek* in 2004. "But it's only by saying no, so that you can concentrate on the things that are really important." Jobs' obsession with process and detail even filters down to how he rolls out products. Besides exhaustively rehearsing his own presentations, he often insists that executives from partner companies submit to a week or more of dry runs–and has been known to bounce execs at the last minute if they show signs of nerves that could mar a Jobs keynote.

Jobs commands Apple with the discipline and improvisational confidence of John Coltrane. It's not clear who else, if anyone, at the company can groove with equal flair. Executive grooming, like much else at Apple, is handled in an unorthodox way. Most corporations aim to enhance the leadership abilities of their employees. Some, such as General Electric, are veritable factories for seasoned executives. At Apple, rather than recruiting or developing the most promising and versatile general managers, Jobs concentrates on hiring the best person in a given discipline.

The result is a team of highly skilled specialists who operate in a system that still resembles a startup. There are no separate lines of business and no business unit chiefs with responsibility for their own balance sheets. Important decisions are usually made at weekly Monday strategy sessions with Jobs overseeing his 10-member executive team. New executive hires–such as former IBMer Mark Papermaster, who joined as a senior vice-president in 2008 and left for Cisco Systems last year–typically don't last long.

Who will steer the ship when, inevitably, Jobs is gone? Most analysts are unreservedly enthusiastic about the talents of Tim Cook, who is widely viewed as Apple's next chief executive if and when Jobs permanently steps aside. Cook, 50, is an operations genius, adept at cutting costs while delivering complex products on time and coping with staggering growth targets. He's also monastic and incredibly devoted to Apple. He has oversight of sales, customer support, and logistics–meaning much of the company already reports to him. During Jobs' previous two absences, Cook steadied the corporate ship so capably that in 2010 he was rewarded with $59 million in salary and stock. Still, during those past medical leaves and now this new one, Jobs has remained involved in all major strategic decisions, Apple says. In that respect, Tim Cook is untested as a potential CEO.

The rest of Jobs' team is studded with star role players but not accomplished generalists. Jonathan Ive, Apple's design chief, joined the company during its churning descent in 1992 and is now easily the most famous industrial designer in the world. But he lacks overall business expertise and credibility with Wall Street. Marketing chief Philip W. Schiller is a burly, jovial Massachusetts native and a committed hockey fan. He's known as loyal and effective but isn't considered a tech visionary. Scott Forstall, Apple's software chief, carved out a high profile in Silicon Valley by creating a platform for the iPhone that made it easy for developers to create applications. But the longtime Jobs ally has little experience minting new hardware. Ron Johnson, the head of retail operations, has helped turn Apple into one of the world's most profitable chains–and somehow manages to coach youth baseball at the same time–but he is a retailer, not a technologist.

Apple has a team of highly skilled specialists who operate in a system that still resembles a startup

Some outsiders fear that Jobs alone can stir this mix of talent. Take him out of the picture and the water goes calm, says a manager who does business with Apple, who did not want to be quoted by name because it would hurt his business relationship with the company. During Jobs' last absence, this person says, the creative tension disappeared, replaced by a play-it-safe ethos. The unavoidable fact is that lots of people can manage the company. Only Steve Jobs could have had the visionary spirit–and risk tolerance–to turn Apple into a mobile phone company.

In the short term, however, the current team might actually outperform in the absence of its mercurial and stubborn mentor. Without Jobs' obstinacy at the negotiating table and unrelenting dedication to simplicity, it's possible Apple could have avoided its rare mistakes, such as waiting too long to move the iPhone to Verizon (which gave momentum to phones powered by Google's Android operating system) and blocking Adobe's popular Flash video format on the iPad. An Apple without Jobs might one day even allow the iTunes media store to appear on devices such as HDTVs made by the likes of Sony and Samsung. Or perhaps Apple could introduce a stripped-down version of the iPhone to compete with lower-cost handsets. These moves would likely horrify Jobs; he would see them as muddying the user experience and diluting the Apple brand. Yet they also make some business sense.

Business history is replete with visionary founders whose companies survived and even thrived after they stepped away. Ford Motor reached its zenith in the 1950s, a decade after the death of Henry Ford. Hewlett-Packard continued to grow after its namesake founders retired. Disney foundered after Walt Disney

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Opening Remarks

died in 1966 but was revived two decades later under Michael Eisner.

Those founders were 20th century inventors who didn't think much about implanting perceptions of entire lifestyles in the consumer mind. Twenty-first century leaders such as Jobs are holistic innovators of both product and brand, says Warren Bennis, a professor of business administration at the University of Southern California's Marshall School of Business. "There is a different kind of innovation today that has to do with crafting the overall experience," he says.

Jobs may be the best example of a new breed of business leader who can intuit customer emotions. Another is Howard Schultz, the longtime CEO of Starbucks, who is selling not just high-priced coffee but also the idea of a "third place" between home and work. Such leaders are not easily replaced. When Schultz retired from Starbucks in 2000, the company went into a steep decline, and he was compelled to return in 2008.

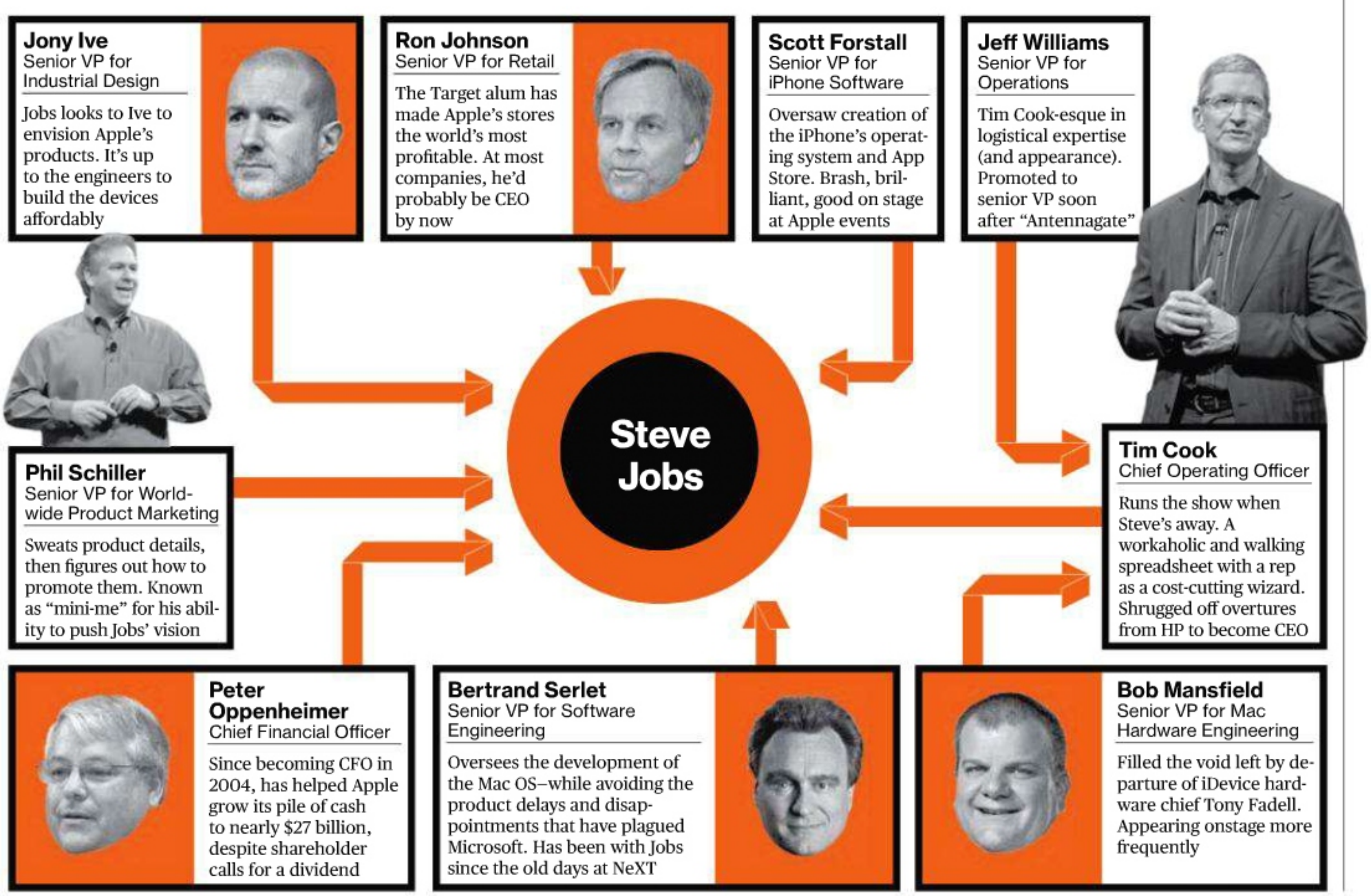
There is also evidence that operations-minded co-pilots fare poorly when they take over the control of companies in rapidly moving industries. Iconic founders such as Michael Dell and Charles Schwab stepped aside at their companies to make way for their operating partners–their Tim Cooks, if you will–and then were forced to return when the successors ran into trouble. "The period after the charismatic leader is gone is always perilous, but in hypercompetitive, fast-moving industries, the loss becomes apparent much more rapidly," says Jay A. Conger, a professor of leadership studies at Claremont McKenna College.

Even without Jobs at the helm, Apple could still deliver satisfying returns for shareholders. It can continue to press its gains in PC and mobile market share around the world, and it could build a sizable business selling to corporations. In that respect, Apple without Jobs could come to resemble a successful, if less sexy, company such as IBM, moving from a business of generating reliable "hardware hits" to one focused on recurring revenues from online ads, cloud services, and long-term contracts with companies.

All this is speculative, of course, given the uncertainties about Jobs' health. But there is nothing speculative about the eventual mortality of any leader, as Max Weber noted long ago. He saw much of human accomplishment, from the world's religions to the great railroad companies of the era, as the work of revolutionary individuals whose legacies survived only when their wisdom was preserved in institutions. Those institutions inevitably become less radical over time, as obedient disciples take over and eventually form a less innovative, more risk-averse bureaucracy. It's not an especially auspicious way to look at Apple's future. But it suggests that whatever happens, the spirit of Steve Jobs will live on within Apple, and when it finally has to, Apple will carry on without him. B

—With Adam Satariano

Summing Up the Parts



BLOOMBERG(4); APPLE INC. VIA BLOOMBERG (2);PAUL SAKUMA/AP PHOTO(1)

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Global Economics

At Davos, Bankers Want the Good Old Days Back

"The Economic Outlook and Defining Policies for Inclusive Growth"

"Supporting the G-20 Agenda"

"Back on Track"

"Shared Norms for the New Reality"

■ Agenda Items

"Doing Better With Less"

"Responding to the New Reality"

"Building a Global Risk Response Mechanism"

▶ **A dense agenda touches lightly on what caused the financial crisis**

▶ **Cybersecurity and carbon footprints round out the list**

"There was a period of remorse and apology for banks; that period needs to be over." Thus Bob Diamond, the chief executive officer of **Barclays**, tried to draw a line under the credit crisis during a 2½-hour grilling by Members of Parliament at the House of Commons Treasury Committee on Jan. 11. The "blame game," he told the MPs, has hamstrung the finance industry for long enough: "Now, we need to build some confidence." Never mind that most of us must have blinked and missed the bankers' self-excoriation; Diamond would like to return to business as usual, without pesky regulators hobbling risk-taking.

So when Diamond travels to Davos to hobnob with his fellow Masters of the Universe at the World Economic Forum's annual shindig, the theme set by the event's organizers—"Shared Norms for the New Reality"—will be wildly inappropriate. While there may be a new reality, the norms arising from the financial disaster's aftermath aren't shared by Davos Man.

The Davos agenda—which runs to 110 pages in a Word document, even shrunk to a font size of 10-point Arial—doesn't ignore the parlous economic backdrop that the mishaps of the banking fraternity created. Yet the questions posed by the event's organizers don't seem particularly challenging. One workshop asks whether the international financial system is "back on track." The panel, featuring Gary D. Cohn, the chief operating officer of **Goldman Sachs**, is hardly likely to conclude that the financial system is still headed in the wrong direction with regards to transparency, bonus culture, and making sure a crisis doesn't happen again. Also featured are cybersecurity (a hot topic now that *The New York Times* has presented evidence that the U.S. and Israel deployed a computer virus to hobble Iran's nuclear programs); the environment (a bit rich, given the carbon footprint caused by shipping thousands of executives and media hangers-on to the Swiss Alps); the future of employment (how many Davos panelists cut jobs in the recession?); and a session on "Doing Better With Less" (or, how the public sector is paying for the private sector's misadventures).

Diamond, who will sit on a panel examining the global economic outlook, is the archetypal Davos Man. ➔

The high profiles of China and India at the WEF suggest Davos Man must look East to see the future

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Global Economics

An American presiding over one of Britain's great banks, he was at the eye of the credit-crunch storm. He's not alone in urging the world to move on. "We've got to work for the balance, rather than just say let's get revenge on these people," British Prime Minister David Cameron said earlier this month.

Barclays vigorously defends its chief's recent comments. "Mr. Diamond made it perfectly clear that the role of banks in the U.K. and elsewhere is to support businesses and households, and that is exactly what Barclays is doing," says spokesman Giles Croot. Still, the Barclays CEO's desire for closure is a lot easier to understand once you know that Diamond—who pocketed more than $32 million between 2005 and 2007, when the seeds of the crisis were sown by banks like his—has had to forgo his bonus for the past two years.

The WEF, which kicks off on Jan. 26, has also defined four "thematic clusters" for the gathering. "Responding to the New Reality" focuses on the fear factor; new players are competing for finite resources, the agenda says. In other words, China is snapping up coal mines, farmland, and more worldwide. "The Economic Outlook and Defining Policies for Inclusive Growth" riffs on the risks of double-dip recession as economists debate whether deflation or inflation is the bigger threat. "Supporting the G-20 Agenda" comes with the caveat that achieving financial stability "will require significant engagement from economies outside the G-20." That comment gives at least a nod to the ascendancy of emerging economies as the drivers of growth. The fourth item promotes "Building a Global Risk Response Mechanism," which seems to ignore the sad truth that nations have proved unwilling to cede sovereignty even as globalization gathers pace.

Implicit in the agenda is the idea that while the West has fouled its economic sandpit, other nations are speeding ahead. The inclusion of Indian Finance Minister Pranab Mukherjee on Diamond's panel, the talks promising "Insights on China" and "Insights on India," and the appearance of Chinese and Indian executives on the panel opening the whole event—all suggest that Davos Man must look East to see the future.

A survey conducted by the Pew Research Center for the People & the Press on Jan. 5-9 showed 47 percent of Americans now consider China the top economic power. In a similar poll in 2008, 41 percent named the U.S. top dog. While Davos Man didn't switch the pecking order, the crisis he triggered surely accelerated the change.

That shift, in a way, was clearly acknowledged on Jan. 19, when President Barack Obama held the first state dinner for a Chinese President since 1997. When the guy who has loaned you $907 billion comes calling—China has about a third of its foreign-exchange reserves parked in the U.S. government bond market—it makes sense to put out the welcome mat. —*Mark Gilbert*

The bottom line *Davos promises to look at "shared norms for the new reality." Many participants would rather return to the realities of a few years back.*

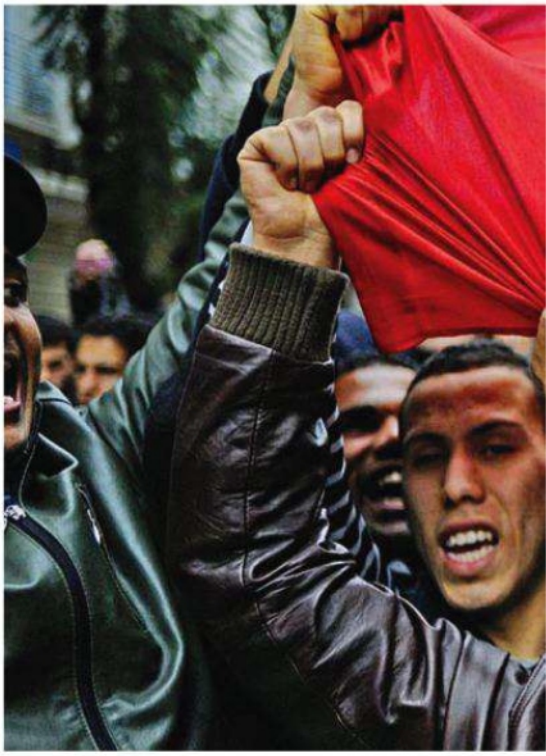
Leadership

The Search for a Few Good Davos Women

▶ **The WEF wants more women—without sapping the power quotient**

▶ **"Women are not at the top, and they want the top people"**

Last year on the way to the World Economic Forum's meeting in Davos, investment banker Jane Gladstone unwrapped eyeshades for her flight—and then didn't sleep a wink. In the next seat was Michele Burns, chief executive of **Mercer**, the Marsh & McLennan consulting unit. They talked through the night. "That's a very Davos experience," says Gladstone,



who leads **Evercore Partners**' financial services advisory business. The two women have since introduced each other to business contacts.

That's the way things happen at Davos, but relatively few women have the opportunity to attend the big networking event in the Alps. About 16 percent of last year's delegates were women, roughly the same as in 2005, according to the WEF. That's up from 9 percent a decade ago, when organizers began to seek out more women.

To boost the number of female attendees, the forum's 100 strategic partners—companies including **Goldman Sachs** and **Volkswagen** that donate more than $500,000 a year to the organization—have been asked to fill at least one of their five allotted Davos slots with a woman. "It's a fairly aggressive policy," says Saadia Zahidi, who heads the WEF's gender parity program.

The problem for the WEF is that founder Klaus Schwab bills Davos as a meeting where elite leaders talk candidly about global problems, and there aren't many women who run companies or countries. "What makes Davos Davos is that Bill Gates and Richard Branson and the Nobel Prize winners are there," says Herminia Ibarra, a professor at French business school INSEAD. "Women are not at

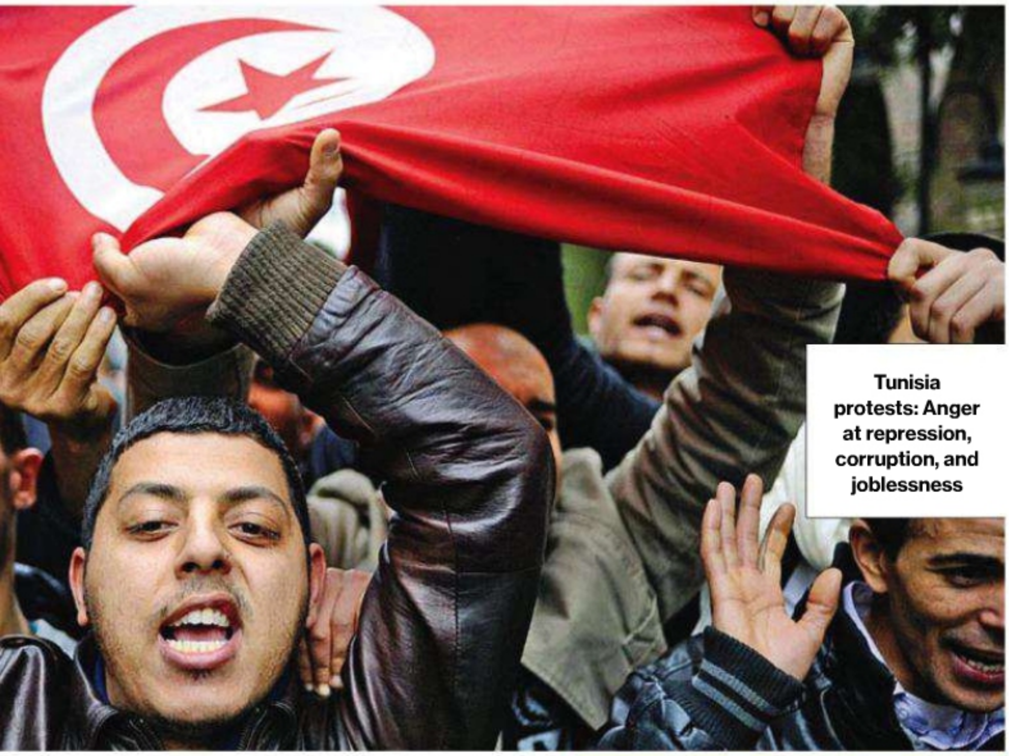
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"The currency issue is part of the problem. The renminbi is undervalued. The Chinese government has intervened forcefully in the currency markets. There has been movement on the issue but not as fast as we want." —President Barack Obama at a joint press conference in Washington with Chinese President Hu Jintao on Jan. 19





Corporations return to the Super Bowl
page 22 ▶



Tunisia protests: Anger at repression, corruption, and joblessness

the top, and they want the top people."

Of the world's 500 biggest companies, fewer than 3 percent have female chief executives, and fewer than 20 countries are led by women, Zahidi says. "There is a pretty clear reason for why we have been wavering," she says. "The reality is that there are very few women that occupy these positions." This year's suggested quota may double the number of women attending from the 100 companies, she says. The suggestion isn't being heeded by everyone. **Deutsche Bank** has no women on its list, although it could have gained an extra slot if it had a female attendee.

A Davos roster that's about 20 percent women won't add a sufficient female perspective, says Marie Wilson, author of *Closing the Leadership Gap: Why Women Can and Must Help Run the World*. She thinks 30 percent would be a better minimum goal. "It's really important to get those numbers. It would normalize the conversation and just take the gender issue off the table," she says.

Mercer's Burns points out that most companies have women who can carry their end of the conversation at Davos. "And if there isn't one," she says, "that's a problem too." —*Lisa Kassenaar*

The bottom line *The WEF is encouraging companies to send more female executives to Davos. In 2010, 16 percent of attendees were women.*

Protest

Youth Unemployment Shakes the Arab World

▶ **The plight of the young jobless set the stage for the Tunisian revolution**

▶ **"The private sector has been hamstrung by regulation"**

The "Jasmine Revolution" that brought down Tunisian President Zine al-Abidine Ben Ali came as a shock. Tunisia's annual per capita income of $9,500 outstrips those of other North African countries. Its business schools attract students from its neighbors, and Tunisian women are among the least restricted in the region.

Scratch a little deeper, though, and the country has the same problems as the rest of North Africa and much of the Middle East. Tunisian unemployment is officially 14 percent. According to political scientist Azzedine Layachi of St. John's University in New York, the jobless figure may be 35 percent for youths. The economies of Tunisia and its neighbors—suffocatingly bureaucratic and dominated by the state—cannot create jobs for many of the 1 million or so university graduates and other young people coming onto the labor market each year.

As prices for commodities such as wheat rise, the decades-old practice of buying off the discontented with cheap bread and other subsidies is becoming unaffordable. Egypt already devotes 20 percent of its budget to subsidies for food and fuel. "Many of the governments in the region are going to be under pressure over the next few years," says Tarik Yousef, dean of the Dubai School of Government. The Arab economies must grow 6.5 percent per year to bring down unemployment, according to a recent International Monetary Fund study—about two percentage points higher than the region has achieved over the last decade.

Executives complain that overcrowded universities are not turning out graduates with useful skills. "Language and technology skills are a must in today's job market, but the public education systems are not providing these," says Fadi Ghandour, chief executive officer of Amman-based Aramex, the region's largest courier company. Large state companies that overpay their employees in unproductive operations hobble the economies of Egypt, Syria, and Jordan. In Egypt, new hires in the public sector are paid 46 percent more than private-sector counterparts, according to the IMF, while red tape discourages hiring. "In many countries, the private sector has been hamstrung by regulation and unable to take over the role of creating jobs," says Paul Gamble, head of research at Jadwa, a Saudi investment bank.

Tunisia during Ben Ali's 23-year rule actually had one of the better economic records. In the 1990s the country turned itself into a workshop for Europe. Over the last five years annual growth has averaged a respectable 4.7 percent. Then the 2009 slowdown in Spain and Italy hurt Tunisia, which sends 80 percent of its exports across the Mediterranean. Rachel Ziemba, a Roubini Global Economics analyst in London, says the focus on low-value-added activities such as textiles left Tunisia vulnerable to cheaper Asian competition. "An economy that was already anemic, unable to create jobs, suddenly dried up more," says Christopher Alexander, a Tunisia expert at Davidson College in Davidson, N.C.

The worsening economy, combined with repression and resentment of the corruption around President Ben Ali, set Tunisia up for a fall. The protests started when a 26-year-old fruit and

FROM TOP: MICHAEL VENTURA/ALAMY; FRED DUFOUR/AFP/GETTY IMAGES; EVAN VUCCI/AP PHOTO

worldmags

Global Economics



vegetable seller, Mohamed Bouazizi, set fire to himself on Dec. 17 in the town of Sidi Bouzid after the authorities ruled his cart illegal. As with the 2009 protests in Iran, word of this harrowing event instantly ricocheted around the country via Twitter, blogs, and other digital media.

With one Arab regime down, others may be at risk. Riots over food prices have erupted in Algeria and Jordan, while sectarian protests have shaken Egypt after the bombing of a Coptic Christian church. "The risk of a spill-over of Tunisia's crisis to the rest of the region is not negligible," said Barclays Capital in a recent note.

Fear of being the next Tunisia may cause regimes to cancel reforms, worsening their problems over the long run. Jordan, where protesters want to oust Prime Minister Samir Rifai, has pledged $225 million to cut prices on food and fuel. Libya has followed suit. One worry, says Roubini's Ziemba, is that these increased welfare budgets will eventually lead to spending cuts in infrastructure.

While Egypt, the most populous Arab country, has pursued reforms to encourage foreign investment, it still suffers from the legacy of socialist inertia. With the successor to 82-year-old President Hosni Mubarak as yet undetermined, tensions are rising. "The people cannot live according to the same old model at a time when the regime is unable to fulfill the needs of its citizens," wrote Osama El-Ghazali Harb, an opposition leader, in the *Al Masry Al Youm* newspaper on Jan. 16.

Even oil-rich Saudi Arabia cannot create enough jobs for its youth. Unemployment among Saudis aged 20-24 is 43 percent, according to the government. Saudi businesses prefer to hire expatriates, mostly Asians, for a fraction of what they would need to pay locals. Wealthy Saudis profit by selling visas to expatriate workers, according to Mohammed Al-Qahtani, a Saudi dissident (the government threatens to fine and jail those who sell visas). "Our demographic circumstances are pretty much similar to Tunisia, with nearly 60 percent of our population under 25, failed education, no job opportunities, and no future," he says. An exaggeration, perhaps, but food for thought.

—Stanley Reed, with Caroline Alexander, Glen Carey, Massoud A. Derhally, Nayla Razzouk, and Alaa Shahine

The bottom line *Tunisia's revolution highlights the region's economic fragility, especially in the vital area of youth employment.*

Defense

The French Fighter That Nobody Wants

▸ The Rafale has cost $53 billion. Buyers have plenty of alternatives

▸ "We buy American because it assures security"

The Rafale fighter, made by France's **Dassault Aviation,** is loaded with high-tech avionics, radar, and targeting systems. Now all it needs are customers. France has been peddling the supersonic jet since 2000 and hasn't sold a single one. In the latest setback, Brazil said on Jan. 17 that it would reopen bidding for a fighter contract worth up to $7 billion—a deal France had thought it was close to sealing last year. Neither Dassault nor the French Defense Ministry would comment on Brazil's decision.

The Rafale's plight signals the end of an era for France. With their Mirage fighter program, developed in the 1950s, the French were able to bolster their national defense, promote new technologies, and provide well-paying jobs—while recouping

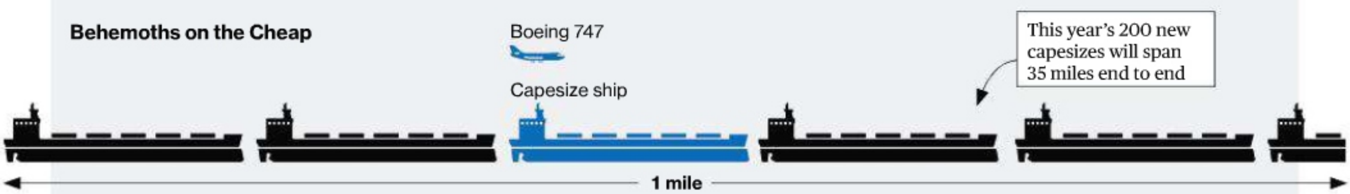
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Maritime Shipping

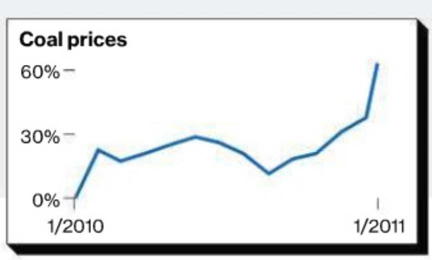
Lots of Coal—and Too Many Ships

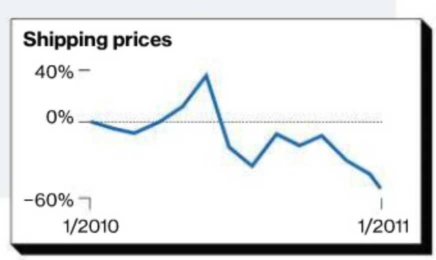
Capesizes are 1,000-ft.-long ships that carry coal, iron ore, and other commodities. (The name comes from their being so big they couldn't sail through the Panama Canal and had to go around Cape Horn instead.) This year some 200 newly built capesizes will expand the fleet by 18 percent, while shipments of iron ore and coal are expected to grow by 7 percent. As a result, leasing rates should drop 34 percent, to an average $22,000 a day. *—Alistair Holloway*

Behemoths on the Cheap









DATA: THE STEEL INDEX, COALINQ COAL PRICE INDEX, BALTIC DRY INDEX (COMPOSITE OF PRICING INDICES FOR CAPESIZE AND OTHER LARGE SHIPS)

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Charlie Rose talks to Henry Kissinger

"On the Chinese side, the belief is that China has suffered a century of humiliation"



Almost 40 years ago, he helped open a dialogue with China. As Hu Jintao visits the U.S., Kissinger offers his take on the relationship between the world's top economic powers

I'll start by quoting you: "Hu Jintao's visit to the U.S. will play a very important role in drawing up the blueprint for the development of U.S.-China relations." What should be in those blueprints?
When I came to China on the first visit [with Nixon in 1972], Zhou Enlai said to me, "This will shake the world." Now we have a different problem. The problem isn't to shake the world. We have to [work] together, which is not the operating style of our societies. If both countries recognize–which I think they are beginning to do–what their real task is, that it isn't just to stop the immediate day-to-day tensions but to have some vision. ... Now, how well they can do it, how quickly, that remains to be seen.

You've also said that elites in both countries would like to see more confrontation and less cooperation.
Well, each side has its own view. On the American side, the argument is that the Chinese can't be trusted, that the Chinese really want world domination, that they are taking advantage of us in the transfer of technology and also that the Chinese in the last year have conducted themselves in a more assertive way than we have been accustomed to. On the Chinese side, the belief is that China has suffered a century of humiliation, or more than a century, and that it's now their turn to demonstrate at least equality. Then there are people in China who believe that the West and the U.S. are now in a uniquely vulnerable position. Based on the speeches that Hu Jintao gave–and his top adviser, Dai Bingguo, made a very major statement–at least the governing group in China today recognizes that long-term cooperation is important. It's also the evolution that the Obama Administration has undergone.

You've watched China for 40 years. Have they become more confident? More aggressive?
They've become more assertive. The impact of our economic crisis in China was both practical and, above all, psychological. There was a general belief that in the field of economics, especially of global management of economics, we knew what we were doing and that they could learn from us. So when we had this huge crisis, not only were they disillusioned in that belief, but a lot of policy people who had sent individuals over here to be instructed [had] egg on their faces. That was one track. Secondly, immediately after our crisis began, their exports began to decline. They had a sudden big unemployment crisis. And they have no social welfare system. They moved very decisively with their economy, and employment came back. We have lost some credibility when we now come with advice on what to do with currencies.

The U.S. should not be alarmed that they're building up their navy?
As fast as they can. It depends how far that goes. If they began to contest the American navy in every part of the world, that would be a problem. But both sides have an obligation. This is true wherever you are. If you try to get absolute security, you create absolute insecurity for everybody else. The mere fact that they're building up military force, to some extent, that's going to be a fact of life.

Will China, in 2050, be the most powerful country in the world?
They have been growing at a rate of around 9 percent a year. No country has ever done that. But here is a country whose coast is as developed as any part of the world. The interior is as backward. And then they will have a huge demographic problem starting in 2030. With the one-child policy, the part of the society that has to be taken care of by the working part increases more rapidly in China than I think in any other part of the world. So one shouldn't project a straight line in which China emerges as totally dominant. There is no reason why we should not remain in a position of equality and, in some areas, superiority.

Clearly the currency issue will be at the forefront during Hu's visit. Treasury Secretary Timothy Geithner made that point in a recent speech.
I think he's done a good job. The problem is in part this: Looked at as a single problem, the change in value of the Chinese currency will affect their exports. We ought to find some mutual framework in which their contribution is currency adjustment. And our contribution is X. I don't know what. This is one thing I have been urging. [Then] the other side doesn't have to step up there and say, "We have given this up and can't answer the question of why."

I think this could happen, and I would be amazed if the Administration wouldn't substantially agree with what I've just said. B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

FROM LEFT: BORIS HORVAT/AFP/GETTY IMAGES; ANDREW HARRER/BLOOMBERG; BRAD TRENT

much of the cost by exporting hundreds of jets worldwide. Hoping to duplicate that model, the French government has spent some $53 billion on the Rafale, more than the country's $40 billion annual defense budget. But deal after deal has fallen through, with prospective buyers South Korea, Singapore, and Morocco choosing **Boeing**'s F-15 and **Lockheed Martin**'s F-16 over the Rafale.

Midsize suppliers such as France are being outgunned by bigger competitors. The F-35 Joint Strike Fighter, for example, is being developed by a U.S.-led consortium of nine countries that plan to buy more than 2,500 of the planes. That will ensure plenty of revenue from production and upgrades. Britain, Germany, Italy, and Spain have similarly joined forces to produce the new Eurofighter jet. "Nationally driven, nationally financed and controlled production of the most advanced weapons systems is now the exclusive purview of the U.S. and Russia, and in the future, China as well," says Mark Bromley, a senior researcher at the Stockholm International Peace Research Institute, a Swedish think tank.

Changing global politics has worked against France, too. During the Cold War, France successfully marketed the Mirage as an alternative to U.S. and Soviet planes. Other customers, such as the United Arab Emirates, bought French planes after the U.S. balked at providing high-tech weaponry. Now, though, the U.S. is eagerly seeking sales in the Gulf states. Many foreign governments, in turn, see arms deals as a way to forge closer defense ties with the U.S., says Loïc Tribot La Spière, an analyst at the Center for Studies and Prospective Strategy, a Paris think tank. "The sentiment is, 'We buy American because it assures security,'" he says.

The 93 Rafales produced by Dassault so far have gone to the French armed forces. To sustain production, the government has agreed to spend $1.1 billion on more Rafales over three years, even as it tries to pare budget deficits.

Finding customers will only get harder. As the Joint Strike Fighter enters service, U.S. manufacturers are set to increase their share of the $16 billion-a-year fighter aircraft market over the next decade from nearly 58 percent to more than 67 percent, according to forecasts by the Virginia-based Teal Group aerospace consultancy. Eurofighter and Russian manufacturers will get most of the rest, Teal predicts.

The longer the Rafale order book stays empty, the harder it will be to sell the plane, Teal analyst Richard Aboulafia says. "Customers like to see a home government that is determined to keep spending on buying and upgrading the aircraft" with the latest technology. Instead, he says, the Rafale is on budgetary life support. "That's the last thing you want customers to see." —*Carol Matlack*

The bottom line *France's decision to go it alone on its fighter program has cost the country $53 billion, with no export sales to offset the price.*



Brazil recently postponed a decision to order the Rafale

Currencies

In the Yuan Debate, China's CEOs Speak Up

▶ No rapid appreciation, please. China is under enough stress

▶ "The U.S. isn't taking responsibility.... The whole world is suffering "

One of the topics dominating Chinese President Hu Jintao's state visit to Washington is the yuan. The U.S. feels that China, by loosely pegging the yuan to the dollar, has kept its currency deliberately weak to promote exports, often at the expense of workers in America who cannot compete against the cheap wages of their Chinese counterparts. The yuan has strengthened just 3.5 percent over the last 12 months against the dollar. In contrast, the Japanese yen has appreciated 10 percent.

Hu's government, though, faces strong lobbying of its own from the chief executive officers of major Chinese corporations. The Chinese C-suite opposes a rapid appreciation of the yuan and criticizes the U.S. for weakening the dollar and letting ultra-loose credit conditions fuel asset bubbles in emerging markets.

Shen Wenrong, chairman of **Jiangsu Shagang Group**, the nation's biggest private steelmaker, says China should allow only a "token" appreciation while

Tom Keene's EconoChat

Tom talks about U.S. unemployment with **David Resler,** managing director at Nomura Global Economics

So where does unemployment go this year?
Lower, but not a lot lower. The labor market isn't clearing as quickly as you might expect it to. I think that there are some fairly important structural changes that have gone on in the economy that we have not fully adjusted to yet.

What are they?
Let's take construction. We've lost a couple of million jobs there. You would think that with these declines that there would be more construction workers leaving the market for other endeavors. So far that has been relatively muted. I think as the outlook for housing remains on the soft side, eventually more of those workers will decide it is time to change careers.

How do we clear the housing market, David?
It's going to be difficult with this backlog of foreclosures. I think what the foreclosure mess means is that it keeps valued assets in weak hands longer. What you need to fix a recession is to get assets in stronger hands. Normally that would occur through declines in prices, but the foreclosure process in real estate makes it a much more tedious correction.

Do we have stagnant incomes the next couple of years?
I think it is going to be a slow grind upward. We'll have nominal growth in the three-to-four percent range. That will keep the economy moving but not as rapidly as it might if we were in a more vigorous recovery.



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

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International Financing Review magazine, 2010.
IFR Awards 2010:
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the U.S. is "printing money to stoke inflation." Ma Weihua, CEO of **China Merchants Bank**, says the yuan shouldn't climb too quickly. He thinks the Federal Reserve must show more restraint after planning to buy $600 billion of Treasuries from U.S banks, which will give them plenty of money to lend–money that could end up feeding a bubble in China.

This stance differs from remarks made by some Chinese CEOs in March, when Chinese executives focused on the domestic market backed an end to the yuan-dollar peg. The argument was that a stronger currency would lower import costs and boost consumer purchasing power. Since March, though, the Chinese central bank has raised rates twice and told China's banks to boost reserves. In this context, a hefty appreciation of the yuan may cool things down too much.

Ma of **China Merchants,** the nation's sixth-largest lender by market value, also asks why Hu should be in any hurry to help the U.S. "We hope the yuan will get stronger but don't want the appreciation pace to be too fast," says Ma. "The U.S. isn't taking responsibility. It called on China to adjust its yuan policy, but the whole world is suffering from its easing measures."

3.5%

Gain in the yuan's value against the dollar since January 2010

Shen of steelmaker Jiangsu Shagang says the government has to balance the competitiveness of China's exports against the need to cut raw-material costs. "As a big buyer of iron ore, China benefits from appreciation," says Shen. "But the benefits are limited."

One way or another, "Chinese companies have to face the reality of a rising yuan as the economy grows fast and foreign-exchange reserves increase," Zhang Wei, deputy director of the state-run China Chamber of International Commerce, told reporters in mid-December. "They should also get fully prepared for rising international pressure on China to let the yuan appreciate." B
—*Bloomberg Businessweek*

The bottom line *Chinese CEOs want the government to tread cautiously when it comes to letting the yuan appreciate.*

Seven Days

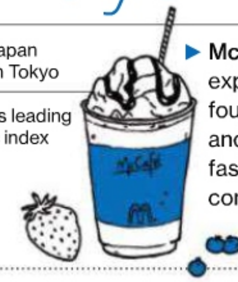
Events of note in the week ahead

by Ira Boudway

24

Bank of Japan meeting in Tokyo

Germany's leading economic index



▶ **McDonald's earnings:** Analysts expect $6.2 billion in revenue for the fourth quarter. The sale of smoothies and frappé drinks has helped the fast-food chain weather declines in consumer confidence.

25

Britain's fourth-quarter GDP

Earnings from Johnson & Johnson, Verizon, and Yahoo!

▶ **State of the Union:** President Obama addresses a divided Congress for the first time.

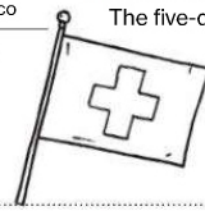
▶ **Nielsen IPO:** The television ratings company aims to raise $1.6 billion on the sale of 71 million shares.



26

Macworld 2011 begins in San Francisco

Federal Open Market Committee meeting

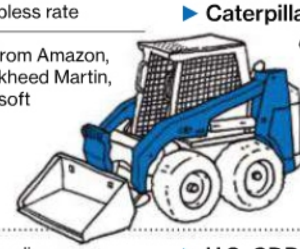


▶ **World Economic Forum:** The five-day annual gathering of the political and business elite in Davos, Switzerland, will focus on "shared norms for the new reality."

27

Japan's jobless rate

Earnings from Amazon, AT&T, Lockheed Martin, and Microsoft



▶ **Caterpillar earnings:** The construction equipment maker raised its annual earnings forecast in October. Analysts expect $11.5 billion in sales for the fourth quarter.

28

Mexico's leading economic index

Earnings from Chevron and Ford

▶ **U.S. GDP:** The world's largest economy grew at a 5.7 percent clip in the final quarter of 2009. It has cooled since. Surveyed economists predict 3.6 percent growth for the fourth quarter this year.

29

Oil & Gas Pakistan forum in Islamabad



▶ **Directors Guild of America awards dinner:** This year's nominees for outstanding directorial achievement include David Fincher for *The Social Network* and Christopher Nolan for *Inception.*

30

Japan's industrial production for December

NHL All-Star game

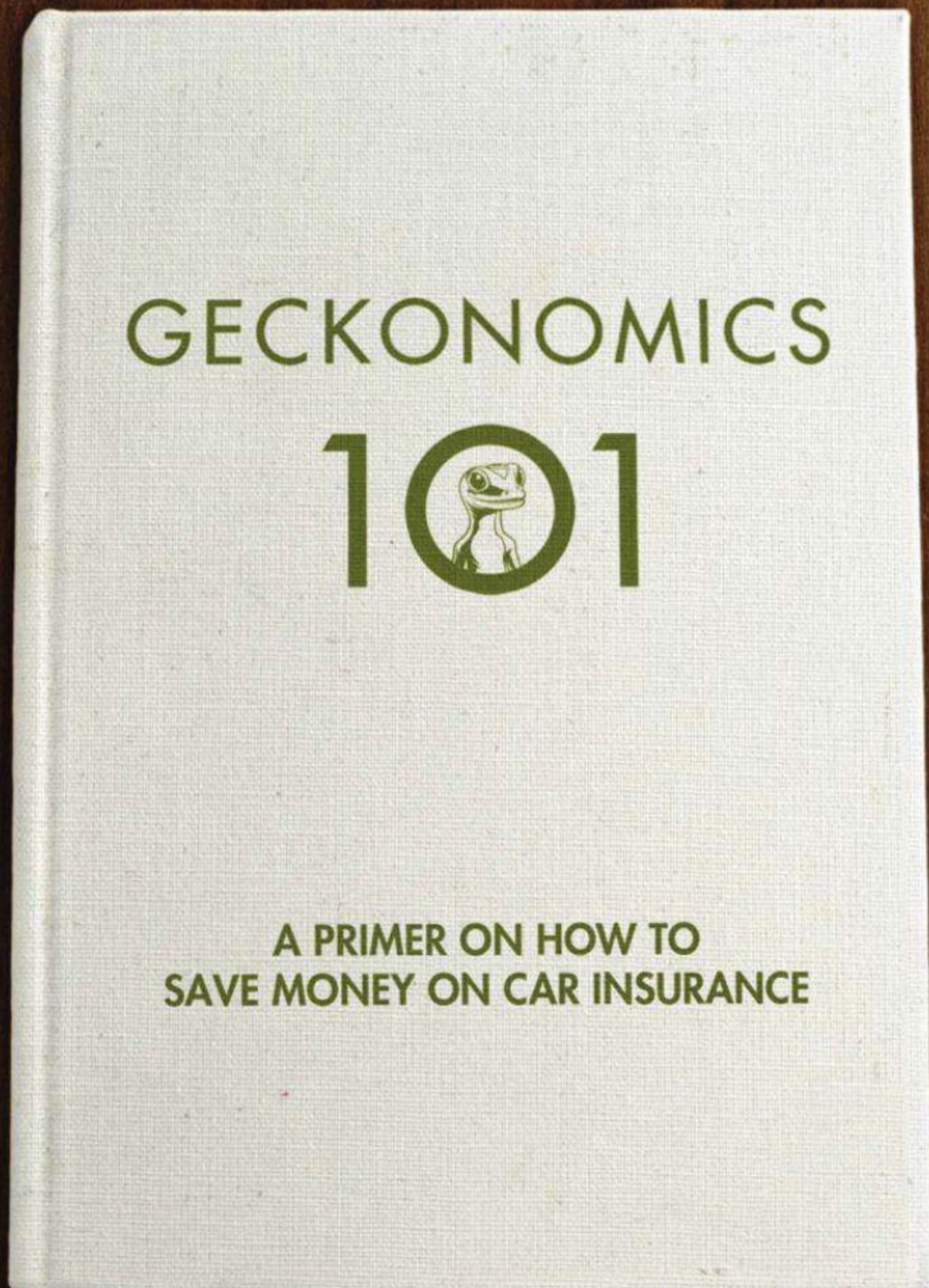


▶ **Australian Open men's final:** Defending champion Roger Federer has won three of the last five.

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ILLUSTRATIONS BY MAAYAN PEARL


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and what you don't.
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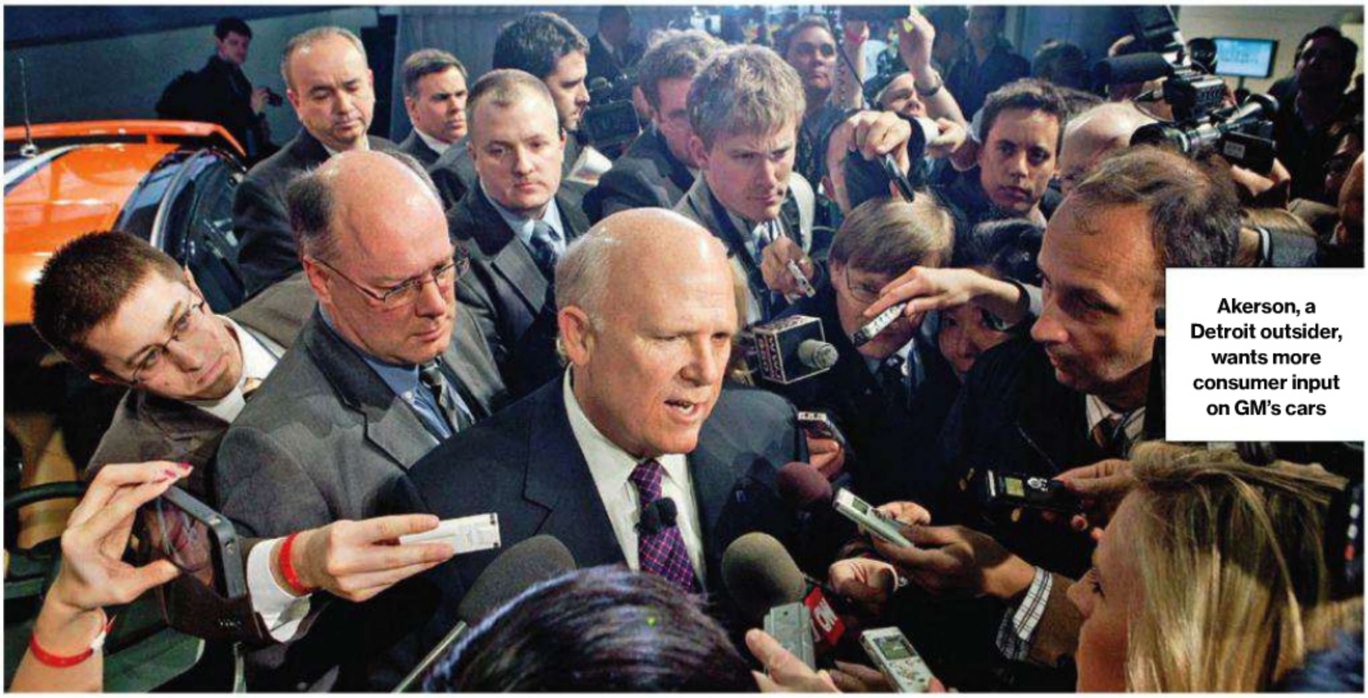
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Contents ▶ Corporate Super Bowl bashes are back 22 ▶ H&R Block: Free tax returns, with a few strings 23 ▶ How flat-screen TV makers sabotaged themselves, and how they're trying to bounce back 24 ▶ Briefs 25 ● Edited by James E. Ellis

Companies&Industries



Akerson, a Detroit outsider, wants more consumer input on GM's cars

ANDREW HARRER/BLOOMBERG

For Dan Akerson, a Magic Moment to Remake GM

▶ **Freed of contract and dealer franchise constraints, the CEO tries building cars that buyers want**

▶ **"The importance of marketing is radically different within GM than ... under past leadership"**

For much of the past quarter-century, senior managers at **General Motors** spent a lot of their time worrying about almost everything but their customers. The automaker's cars were sometimes designed to fit the capabilities of its manufacturing plants, or simply to give its dealers something to sell. Its heavy debt load and rising health-care costs meant it had to be managed to maximize cash, rather than the long-term equity of its brands. And GM's labor contracts all but prohibited layoffs—even if car buyers didn't want the heavily discounted products those surplus workers churned out.

No longer. GM's 2009 bankruptcy and subsequent restructuring allowed it to shed many of the contractual and financial obligations that weighed it down. That's given new Chief Executive Officer Daniel F. Akerson a window to do something radical, at least by GM standards: focus on customers. The automaker is free to design cars that appeal to consumers. It can restrain production to get better pricing. And the slimmed-down company now has money to crank out new models faster and expand the advertising it puts behind them. Akerson "talks about this being a rare opportunity and the fact that we have momentum," says Joel Ewanick, GM's newly named global chief marketing officer, a position 102-year-old GM has never had. "Dan finds it very important that we become consumer-centric and make the company more of a marketing organization."

"We have to benchmark off the competition, not what we see from an internal perspective"

Akerson's first major change since finishing GM's initial public offering in November has been elevating marketing within management. Most significantly, he put Ewanick, who earlier in his career made a name for himself building **Hyundai**'s brand in the U.S., on GM's executive committee with a new mandate: bring a consumer point of view into GM's product planning and strategic decisions.

"The importance of marketing is radically different within GM than it was under past leadership," says James N. Hall, principal of consulting firm 2953 Analytics. "Before, marketing was not involved in product decisions. It was 'here's your car, go and sell it.'"

Akerson's move was more than just another reshuffling at a company that has gone through four CEOs in less than two years. The former telecom executive and private equity partner

is trying to get historically inward-looking GM to find more effective ways to talk to consumers and to accommodate their input before making decisions. Building cars people want to buy rather than what it needs to sell is a huge turnabout for GM. "We want to eliminate insularity," Akerson told analysts on Jan. 11. "We have to benchmark off the competition, not what we see from an internal perspective."

Akerson has been telling his staff that the time is particularly opportune for big change at GM because the automaker's profits are finally rising, and some new models, such as the Chevy Equinox and Cadillac SRX, have become hits. GM in 2010 logged its first profit in six years. The company's overall market share is down because the company hasn't recouped all of the customers it lost by shedding its Hummer, Pontiac, Saab, and Saturn lines. But its four remaining brands–Chevrolet, Buick, Cadillac, and GMC–grabbed 19 percent of the U.S. car market last year, up from a combined 17.2 percent in 2009.

GM still has a long way to go. Only 23 percent of U.S. car shoppers even considered the Chevrolet brand, which accounts for 70 percent of GM sales, according to a survey done in late 2010 by market researcher Strategic Vision. The brand has been stuck around that mark for five years. Despite being dogged by quality problems, **Toyota** gets nearly twice that level of consideration from shoppers. And Hyundai has tripled its consideration percentage to 17 percent since 2005, in part a result of Ewanick's work there.

Part of Ewanick's new job is to get consumer feedback from his staff and bring it to the product team. He had GM cars sent to events in 24 cities to collect direct consumer feedback. And Ewanick has been known to talk to customers in focus groups about GM's products. Using that feedback, he advised design chief Ed Welburn that some future models might need bolder styling to grab attention among today's buyers. In other models, especially Buicks, he wants to push GM upscale with more creature comforts in the vehicles' interiors.

Ewanick prodded GM to declare Buick a luxury brand. Until he arrived, it was positioned as "near luxury" in the U.S., placing it beneath Cadillac in a hierarchy that was created by legendary Chairman Alfred P. Sloan in the 1930s. So now Buick is assigned the task of competing against Lexus with understated luxury, while Cadillac goes up against **Audi** and **BMW** with bolder design and more responsive handling. "Consumers don't want 'near'-anything," Ewanick says. "They don't want to buy a compromise."

Akerson, who ran long-distance company MCI when it introduced its trendsetting Friends & Family Plan marketing program, enjoys discussing the auto giant's marketing and meets with Ewanick to review ads. The GM chief, for example, vetoed some of the violent boxing footage in an early version of a commercial GM ran over the Thanksgiving holiday on concerns that some shots of a prizefighter being knocked down and then struggling up from the mat might be too intense for female viewers.

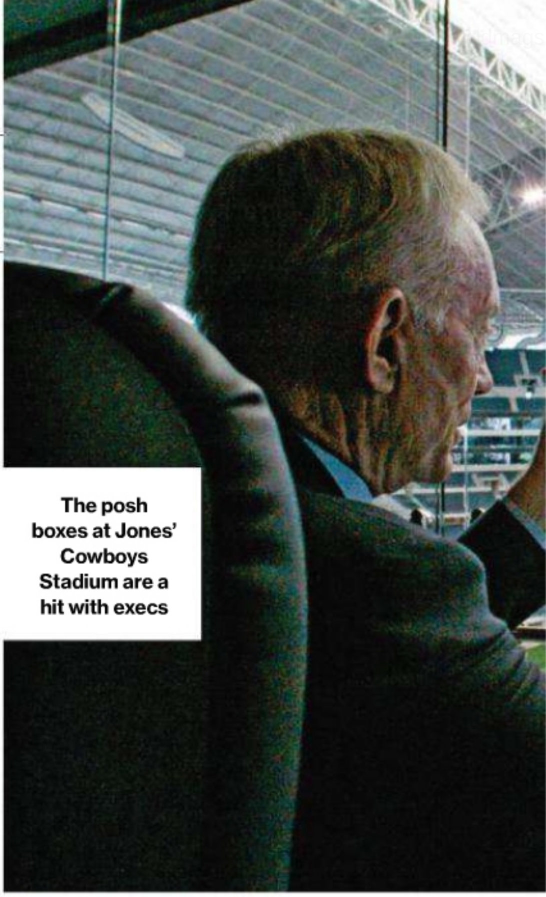
For a GM still struggling to gain its footing, the immediate challenge will be getting new products to market faster. The company in the past year has moved as many as 20 future models ahead of their original production schedules. It plans on fast-tracking even more, says Karl-Friedrich Stracke, GM's global vice-president of engineering. Still, the automaker has few new models scheduled for the next two years, while rival **Ford** has several in the works. For a company seeking a second chance with consumers, a shortage of new cars could make for a tough revival. —*David Welch*

The bottom line *General Motors' restructuring, which reduced labor and operating costs, has left it better able to concentrate on consumers and marketing.*

Quoted

"The man who's been beaten is worth two who haven't."
—Russian Prime Minister Vladimir Putin, quoting an old Russian proverb on Jan. 14 to explain the wisdom likely gained by BP from its disastrous Gulf Oil spill. BP agreed to an Arctic exploration deal and share swap with OAO Rosneft, Russia's largest oil producer





The posh boxes at Jones' Cowboys Stadium are a hit with execs

Sports

Corporations Field A Super Bowl Return

▶ As business rebounds, companies are eager to schmooze clients

▶ "Banks have paid off their TARP funding and are coming back"

Following a three-year period when even the legendary **Playboy Enterprises** Super Bowl parties fell victim to belt-tightening, U.S. companies are staging an entertainment comeback. Spending on lodging, transportation, food and beverage, and entertainment at the National Football League championship games fell 27 percent from 2007 to 2010, according to Pricewaterhouse Coopers. Early indications are that they'll grow considerably at Super Bowl XLV, to be played on Feb. 6 in Dallas, says Robert Tuchman, an executive vice-president at Premiere Global Sports' travel division.

Corporations account for 70 percent of Premiere's business for Super Bowl packages, says Tuchman. He says sales of ticket-and-lodging packages, which start at $4,435 per person, are up 50 percent to 60 percent from last year. "Companies are sitting on a lot of money and optimistic enough to spend on events that can generate more sales," says Tuchman.

CLOCKWISE FROM TOP: DONNA MCWILLIAM/AP; SCOTT BOEHM/GETTY IMAGES; RIA NOVOSTI/ALEXEI NIKOLSKY/AP

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During the recession, companies were constrained by appearances as well as finances, says Rob Yowell, president of sports marketing firm Gemini Sports Group. The $8,000 to $10,000 per customer cost of wining, dining, and procuring Super Bowl tickets may pale beside potential returns from a single deal struck during the Big Game, he says, yet many bankers and automakers skirted stadium suites while they were accepting federal bailouts. "Now banks have paid off their TARP funding and are coming back," says Yowell, whose Super Bowl business is up 50 percent this year.

The days leading up to kickoff will be a swirl of parties, including one that will be hosted by Sean "Diddy" Combs and another by actress Pamela Anderson, as well as star-studded charity events, like a bowling match featuring NFL Hall of Famers. Businesses use the celebrity-filled gathering as venues to thank their best customers and to win new ones. Dallas billionaire Mark Cuban says he agreed to co-sponsor a big party with **DirecTV**, because of the exposure it provided for his high-definition television network, HDNet: "We saw this as a unique opportunity to work with them and to put our shows in front of the audience."



In dueling Friday night events, **Anheuser-Busch InBev**'s Bud Light is co-sponsoring the revived Playboy party, while **SAB-Miller**'s Coors Light hosts at Billy Bob's Texas, a huge honky-tonk with country singer Blake Shelton headlining. There's plenty of daytime glitz, too, including DirecTV's fifth annual Celebrity Beach Bowl, featuring entertainers playing flag football with NFL stars on a sand field. Last year's teams included actress Jennifer Lopez and New York Giants quarterback Eli Manning; this year's have yet to be named. The company had a tough time attracting co-sponsors in 2010, but sponsorship revenues are up more than 20 percent this year, says Jon Gieselman, a senior vice-president. New sponsors include **Burger King**, **Diageo**'s Captain Morgan rum, and **AT&T**. "Companies are putting their feet back into the water this year and looking for unique events at which they can entertain their customers and partners," Gieselman says.

Yowell of Gemini Sports Group says the game's venue this year also accounts for the resurgence of corporate spending. Built by Dallas Cowboys owner Jerry Jones and opened in 2009, Cowboys Stadium holds 100,000 spectators and a league-high 300 corporate suites that are a magnet for every football-crazed corporate executive lucky enough to be invited on Game Day. "I don't think business is going back to where it once was," Yowell says, "but the checkbooks are open again." *—John Helyar*

The bottom line *Corporate spending on Super Bowl entertaining fell during the recession. With business rebounding, companies are spending again.*

Tax Preparation

At H&R Block, 1040EZ Is Free

▶ **The preparer handles some returns gratis to get filers in the door**

▶ **"The taxpayer is becoming more ... comfortable doing their own taxes"**

As tax season gets under way, filers are being tempted with a deal: Through Feb. 15, Americans can visit a local **H&R Block** office and file their returns for no charge. No, the free returns are not a charity project, but a way to build foot traffic among early filers—many of whom will likely not be eligible for the deal anyway.

That's because the no-charge promo has an important caveat: It covers only those filing the 1040EZ federal form, about 16 percent of Block customers. The 1040EZ form handles the very simplest tax issues. It can't, for example, be used by anyone who has dependents, makes more than $100,000 per year, is 65 or older, claims adjustments to income such as alimony or tuition deductions, or itemizes deductions. So homeowners who deduct mortgage interest or people with large charitable contributions can't take advantage of the deal. "It's not about giving away business for free," explains Amy McAnarney, Block's senior vice-president for tax operations.

Until they arrive for an appointment, many of these new customers might not realize they need more complex tax forms. While they could wind up paying fees, McAnarney says some could also end up receiving larger refunds. "It's a win-win for the client," she says. Even customers who use a 1040EZ will have to pay Block extra to file their state income tax returns in the 43 states that levy them. Block hopes the promotion will attract younger taxpayers—those who can actually use the 1040EZ—and win their loyalty. The company estimates 55 percent of EZ filers will need to file a more complex form within two years.

A rise in joblessness has hurt business for tax preparers. Total IRS filings dropped 1.7 percent last year, the largest decline since 1971. The number of returns handled by Block retail offices fell 6.1 percent last year.

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California's college crisis page 29 ▶



Morningstar analyst Vishnu Lekraj says in-office tax preparation services continue to lose market share to tax software and websites, which can be much cheaper. "The taxpayer is becoming more and more comfortable doing their own taxes," he says.

The free filing promotion will replace Block's big marketing program of recent years, the Instant Money refund. Those "refund anticipation loans" let customers leave a Block office with a check immediately after filing, rather than waiting eight weeks for their IRS refund. But RALs have come under fire by the federal government and consumer groups for high fees and finance charges. Compass Point Research & Trading analyst Mike Turner estimates RALs cost Block's 2010 customers about $67 each, which works out to an annualized interest rate of 54 percent on an average $3,000 refund.

After Treasury Dept. regulators started cracking down, Block's lender, **HSBC**, announced it wouldn't fund the Instant Money program this year. That has left Block without the lucrative product, while competitors like **Jackson Hewitt** still offer it, at least this year. Compass Point's Turner estimates Block could lose 10 to 15 percent of its RAL users; RALs account for about 5 percent of the company's tax revenues, he figures. Block will offer alternatives, including a refund anticipation check that can take eight days to clear, and a prepaid debit card.

Last year the average tax return at a Block retail office cost $189. Company executives don't expect that to decline in 2011, despite giving out free 1040EZ returns, because of the potential to sell customers more complex returns and other products. "Our ability to monetize this program means a minimal impact on our net average charge," Block retail tax President Phil Mazzini told analysts on Dec. 7.

Still, challenges remain. While Compass Point's Turner expects Block will stop losing business to the bad economy, he figures it will continue to lose customers to do-it-yourself computerized filing options. "I would expect their total filers to be down slightly year over year," he says. —*Ben Steverman*

The bottom line *H&R Block is preparing some tax returns for free. Restrictions on the promotion let it upsell other services, minimizing the revenue loss.*

Consumer Electronics

How Marketing Missteps Stalled TV Sales

▶ Stiff prices and a multiplicity of new technologies paralyzed buyers

▶ "Manufacturers threw in everything but the kitchen sink"

Eager to boost profits and prod shoppers to upgrade, television manufacturers last year offered an alphabet soup of new technologies and TV features. **Panasonic**, **Sony**, and other makers plugged big screens that required glasses to see movies in 3D, though there was scant content available in the format. Later in the year, Sony hyped sets using software from **Google**, forcing shoppers to figure out how Google TV might differ from other Web-connected sets—including other Sony models. By the holiday season, techie jargon like LCD, LED, Wi-Fi-capable, widget-equipped, and Internet-ready became a marketing Babel used to convince consumers they needed to buy new models—often at price premiums of up to 50 percent.

Unfortunately for electronics retailers like **Best Buy**, that's resulted in aisles still stacked high with unsold flatscreens after one of the worst TV sales years in a decade. The plethora of choices—and marketing pitches—simply overwhelmed consumers, says Paul Gagnon, director of North America TV research for market tracker DisplaySearch. "Manufacturers threw in everything but the kitchen sink in terms of new technologies," he says, "but the industry made such a big step without lowering prices that consumers figured they'd just wait to see how it shakes out."

North American sales of sets rose just 0.4 percent through September. The most popular category, LCD TVs, fared worse: Shipments actually logged their first annual decline since the technology was introduced in 2006. **Samsung**, **Sharp Electronics**, and other makers blundered by pushing a pricier LCD technology using light-emitting diodes while still selling the older technology, researcher iSuppli says. Rather than choose, consumers turned to lower-priced plasma sets, boosting sales for a mature technology that most makers had written off for dead.

With two-thirds of U.S. households already owning flat-screen sets, the industry is taking radical steps to boost Americans' appetite for upgrades. Before the holidays, Best Buy scrapped most fees it imposed for returning items. It followed on Jan. 10 with an "obsolescence protection plan" that promises consumers a credit of up to 50 percent of the purchase price of televisions and other electronics that can be applied toward a new model, depending on how many months pass before they upgrade. "There's a fair number of consumers on the bubble, not quite willing to make a

It's A Flat, Flat, Flat, Flat-Screen World

Change in 2009-2010 TV sales was driven by a global transition to wide-screen sets

Fast-growing China has become the world's leading market for TV sales

Region	Total shipped in 2010 (millions)	TV type: CRT	LCD	Plasma	OLED	Rear-projection
China	45.2	−62%	+33%	+16%	No Sales	No Sales
North America	42.7	−95%	0%	+26%	No Sales	−8%
Western Europe	42.3	−47%	+16%	+17%	+25%	No Sales
Asia Pacific	36.6	−6%	+44%	+26%	No Sales	No Sales
Latin America	24.9	−25%	+95%	+55%	No Sales	No Sales
Japan	24.1	No Sales	+80%	+29%	No Sales	No Sales
Eastern Europe	16.0	−48%	+43%	+32%	No Sales	No Sales
Middle East and Africa	15.4	−8%	+70%	+77%	No Sales	No Sales

Shipments of LCD televisons nearly doubled in Latin America last year

Organic LED display technology hasn't cracked the mainstream yet

DATA: DISPLAYSEARCH

CLOCKWISE FROM TOP LEFT: THOMAS JACKSON/GETTY IMAGES; ISABELLE SCHNOECKEL/GETTY IMAGES; JB REED/BLOOMBERG; PAUL SAKUMA/AP

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purchase because they fear some other new thing will come down very quickly," says George Sherman, Best Buy's senior vice-president of services.

The plan, which charges an up-front fee of 7 percent to 20 percent of the price for TVs, will offer peace of mind to shoppers worried that a purchase could be out of date within a year, Sherman says. In a Best Buy-commissioned study by Impulse Research, 40 percent of consumers surveyed said concerns about technology becoming outdated have likely prevented them, or would prevent them, from buying electronic products such as TVs.

The new approach is risky. If used sets from returns flood mature markets such as the U.S. and Europe, it could crimp overall sales growth and hurt manufacturer profits, DisplaySearch's Gagnon says: "In this very new territory, Best Buy may encourage upgrading but ultimately cannibalize the market."

Top manufacturers such as Samsung and Panasonic are hedging their bets. They're introducing more models, but at different price points that let consumers pick the technologies that interest them most. "Last year we launched the world's first full HD 3D TV. That's a lot of initials," jokes Boo-Keun Yoon, president of Samsung's Visual Display Business. The company this year will offer 40 new models in different sizes, price ranges, and technology configurations. That includes an $850 50-inch 3D plasma set, rising to an ultrathin 75-inch LED 3D Web-enabled unit priced north of $4,000.

Uncertainty over whether shoppers will warm to the new marketing plans is pushing TV makers to keep inventories lean. Production in the first three months of 2011 is expected to fall 12 percent, according to a DisplaySearch survey. One lesson TV makers seem to have learned is not to assume that if you build it, consumers will come. Panasonic has decided not to emphasize new features without clearly explaining that upgrading still allows buyers to use their TVs as they always have, says Joseph M. Taylor, chief executive officer of its U.S. division. "In the end we had to change our messaging that our 3D sets also offer the best 2D experience people were going to get," he says. B —*Cliff Edwards*

The bottom line *TV makers introduced competing technologies last year, confusing consumers. Now the industry is working to ease fears about buying.*

Briefs

by Caroline Winter

Inmet Mining, Lundin Mining
Pooling resources



Toronto-based mining companies Inmet and Lundin have agreed to merge and form a Canadian copper producer named Symterra, with a market value of about $9 billion. By pooling their global resources, the companies hope to produce more than 500,000 metric tons of copper annually by 2017. Prices for the metal are up 28 percent over the past 12 months, hitting a record $9,754 per metric ton on the London Metal Exchange on Jan. 4. The surge is fueling a rush of mergers and acquisitions among miners, with $87.8 billion worth of deals announced globally in the past 12 months, up from $43.5 billion a year earlier, according to data compiled by Bloomberg.

Yum! Brands
Shedding brands to focus on China



Yum! Brands, best-known for its KFC, Taco Bell, and Pizza Hut franchises, plans to sell its Long John Silver's and A&W-All American Food restaurants to focus on expansion in China and other emerging markets. Nearly two-thirds of the Louisville-based company's business already comes from overseas. The two brands, which account for roughly 1,600 outlets in Yum's portfolio of 37,000 restaurants worldwide, will likely fetch a total of $150 million to $200 million, according to Credit Suisse analysts.

Cargill
Mosaic is up for grabs

Cargill plans to divest its 64 percent stake in Mosaic, North America's No. 2 fertilizer producer, in a $24.3 billion transaction that will trigger no tax liabilities for either company. The agribusiness giant will exchange shares in Mosaic for its own stock and debt. Mosaic CEO Jim Prokopanko says his company could become a possible takeover target once the divestment is in motion. Rising global demand for food is spurring interest in agricultural-chemical companies. Last year, Australia's BHP Billiton launched a $40 billion takeover bid for Potash of Saskatchewan, the world's largest producer of the fertilizer component, only to be rebuffed by Canadian authorities.

Goldman Sachs
Drop in trading revenue hits earnings

Goldman Sachs' fourth-quarter earnings fell 52 percent, the third straight quarterly decline, as a slowdown in trading and investment banking reduced revenue more than analysts estimated. Full-year revenue was down 13 percent to $39.2 billion in 2010 from $45.2 billion in 2009, said the New York firm. The bank's reputation took a hit last year as client-trading revenue dropped 33 percent, from a record in 2009, and the bank settled a civil fraud lawsuit filed by the Securities and Exchange Commission. Goldman recently announced new business practices and changed its financial reports to separate client-trading revenue from gains and losses generated by bets with its own money.

GlaxoSmithKline
Billions more in legal costs



U.K. drugmaker GlaxoSmithKline anticipates fourth-quarter legal costs of $3.5 billion because of a U.S. investigation into sales practices for certain products, as well as lawsuits related to its Avandia diabetes drug. The new charge brings the amount Glaxo set aside for legal costs in 2010 to roughly $6.4 billion. Once the world's best-selling diabetes medication, Avandia ran into trouble after regulators said it increases the risk of heart attacks. Analysts expect the company to report a loss for the fourth quarter when it releases results on Feb. 3.

On the Move **Canada Post** **Former Pitney Bowes executive Deepak Chopra named CEO** • **Citigroup** **John Havens named president and COO** • **Roche** **Former ThyssenKrupp CFO Alan Hippe named CFO**

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Politics&Policy

The GOP's Shadow Fed Chairman

▶ Economic policy critic John Taylor revitalizes Republicans

▶ "Probably the leading voice ... in proposing an alternative view"

He doesn't have a vote in Congress. He doesn't sit on the powerful Federal Open Market Committee. He isn't a member of President Barack Obama's Council of Economic Advisers. Nonetheless, Stanford University's John B. Taylor is considered one of the most influential economic voices in Washington.

Taylor's followers include the new GOP House leadership, the chairmen of key House committees, Presidential hopefuls, conservative thinkers, and others suspicious of Federal Reserve Chairman Ben Bernanke's stimulative monetary policy and perceived alliances with Obama Administration officials. His Economics One blog is a must-read for Republicans seeking an alternative economic blueprint–and for Democrats hoping to deflect it. Representative Paul Ryan (R-Wis.), who chairs the House Budget Committee and speaks to Taylor every two to three weeks, says he "is probably the leading voice with the highest level of credibility in proposing an alternative view to the Fed's."

Taylor, 64, seems to relish his new role as shadow Fed chairman. He has produced a flurry of well-timed newspaper op-eds and open letters, speeches, and papers. "I think there's a responsibility in civil society to speak out," Taylor says. Some of his views have hit a nerve. "He's very mild-mannered and easygoing personally," says Alan S. Blinder, the former Fed vice-chairman. "When he gets the word processor in his hand, he sometimes is intemperate."



Taylor is the go-to economist for GOP House leaders and other pols

It's not just the Fed's easy-money policy that gets Taylor typing furiously. He's also critical of the Dodd-Frank financial regulatory overhaul and former Fed Chairman Alan Greenspan's monetary calls. Taylor claims that had Greenspan followed his monetary policy formula, called (what else?) the Taylor Rule, interest rates from 2002 to 2005 would have been higher, preventing the housing bubble and bust and the unemployment that followed. Greenspan counters that Taylor has made "a number of inaccurate connections" about his record.

Taylor also decries Obama's $814 billion economic stimulus package, saying it neither boosted the economy nor lowered unemployment. States mostly used the funds to reduce their level of borrowing, he says, rather than to increase spending.

Raised in Pittsburgh, where his father was a nuclear engineer, Taylor became a household name among economists with a 1992 speech in which he introduced the Taylor Rule. It grew out of work he did as an economic adviser to President George H.W. Bush. Even Bernanke once said the rule is "remarkably useful" as a guide to set the Fed's benchmark interest rate. Simple enough to fit on his business card, the formula recommends a target rate based on how far inflation and economic growth are deviating from ideal levels, pegged in Taylor's original work at 2 percent for inflation and 2.2 percent for growth. Taylor says the recipe would produce a Fed interest rate close to zero, where it is today.

Bernanke, however, says even more stimulus



PHOTOGRAPHS BY MATT SLABY FOR BLOOMBERG BUSINESSWEEK

PHOTOGRAPH ILLUSTRATION BY CREDITTK

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is needed to build demand and lower unemployment. He has pursued a "quantitative easing" program involving large purchases of Treasuries and mortgage debt.

Taylor was Under Secretary of the Treasury for International Affairs from 2001 to 2005, working on post-Sept. 11 projects to contain the flow of money to terrorists and help rebuild Iraq's economy. He returned to Stanford and wrote a 324-page account of his Treasury stint called *Global Financial Warriors*. He was passed over as Fed chairman when Greenspan retired in 2006.

Taylor's latest beef is round two of Bernanke's quantitative easing, dubbed QE2, in which the Fed plans to buy $600 billion in government bonds. Taylor says QE2 shows no evidence of working and risks stoking inflation. Bernanke took the unusual step of defending the policy in a *Washington Post* op-ed and on CBS's *60 Minutes*. He declined to comment for this story.

The critiques by Taylor have inspired some GOP pols. Sarah Palin said in a Nov. 8 speech that she was "deeply concerned" about the potential inflationary effects of QE2. Taylor, who advised John McCain and Palin in the 2008 Presidential campaign, says he has not spoken to Palin since the election.

He was among 23 signatories to an open letter to Bernanke in the Nov. 16 *Wall Street Journal* and *New York Times*, calling on him to halt the bond purchases. The next day the four top Republicans in Congress, including now-House Speaker John Boehner (R-Ohio), who had met with Taylor and other economists before the election, wrote to Bernanke expressing "deep concerns" over the purchases. Two weeks later, Taylor and Ryan, in an op-ed in *Investor's Business Daily*, wrote that "QE1 failed to strengthen the economy, which has remained in a high-unemployment, low-growth slump, and there is no convincing evidence that QE2 will help either."

The silver-maned professor is popular among Stanford undergrads; sometimes he pretends to be the voice of Adam Smith, which he pipes in over loudspeakers during lectures. He stresses that he remains friends with both Greenspan and Bernanke. "I feel what I'm doing now, as much as I can, is getting the facts out,"

Taylor says in his office at Stanford's Hoover Institution, where the decorations include framed Iraqi currency he helped create.

Some economists say the Taylor Rule may not be the right prescription for today's economy. "Inflation is a little bit below the target, and unemployment is way above the target, so clearly we need more demand," says Jeffrey A. Frankel, a Harvard professor who was an economic adviser to President Bill Clinton.

Taylor's advice to GOP lawmakers: take away the Fed's discretion to set rates and make it follow a Taylor Rule, or similar recipe. He also proposes stripping the Fed of its mandate to pursue full employment, which Taylor says the Fed has used irresponsibly to justify QE2. Even some of his Fed allies are wary of his by-the-numbers approach. "This is no criticism of John: No model I know of replicates the real world," says Dallas Fed President Richard W. Fisher. Still, with the ear of so many Republicans, Taylor is likely to keep the Obama Administration and the Fed on the defensive for the next two years. —*Scott Lanman*

The bottom line *John Taylor's critiques of QE2 are inspiring Republican leaders to keep challenging Fed and White House economic policies.*

Energy

The Risky Business of Speculation Limits

▶ **The CFTC's Gensler lacks the data, and maybe the votes, to issue rules**

▶ **"Position limits are a cure for a disease that does not exist"**

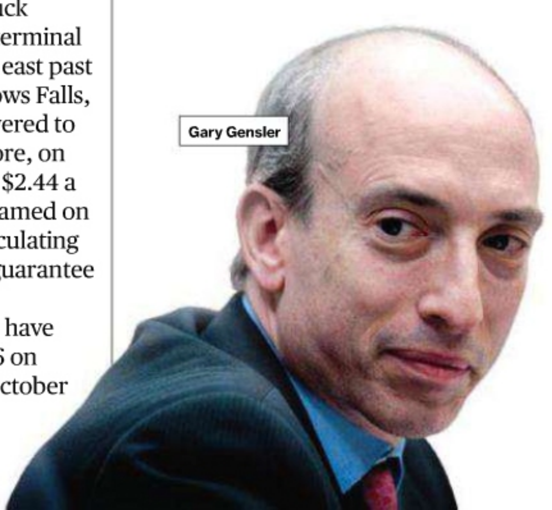
The sun was starting to rise as Fiddle Cote steered his 7,500-gallon truck loaded with heating oil out of a terminal north of Albany, N.Y. He headed east past frost-covered fields toward Bellows Falls, Vt., where the oil would be delivered to customers' homes. The day before, on Nov. 10, heating oil had reached $2.44 a gallon, a price spike that Cote blamed on speculators. "Let them stop speculating for one year," Cote says, "and I guarantee you the price will tank."

Since then, heating oil prices have continued to climb, hitting $2.66 on Jan. 19, the highest mark since October 2008. That price jump, not to mention crude oil near $91 a barrel, has sparked a fresh outcry against speculators. Last year's Dodd-Frank financial reform law lets the Commodity Futures Trading Commission restrain speculators, and the agency on Jan. 13 began the process by proposing a complex array of limits on investors in energy contracts (table).

Trouble is, CFTC Chairman Gary Gensler may lack the votes needed to issue final rules, and his agency has just begun to gather the data it needs to fine-tune and enforce some restrictions. On top of that, newly empowered Republicans in Congress say the CFTC hasn't shown speculation is a problem and is moving too fast. The CFTC says the final limits, if adopted, wouldn't take effect until early 2012. Some Republicans question the need for new rules at all.

Since the mid-1980s, traders have had two ways to bet on energy. They could buy futures on regulated exchanges, where standard contracts determine the price and date of delivery. Or they could negotiate privately for unregulated, look-alike contracts called swaps. Until now, swaps were like a black box, beyond the view of the CFTC. The absence of restrictions allowed investors to pour into the oil markets, says Peter Beutel, president of trading advisory company Cameron Hanover in New Canaan, Conn. "Oil has developed a lot of the same characteristics as gold," Beutel says. "It isn't supply and demand that's driving prices. It's the interest in oil as an asset."

The agency, however, has little idea how many swaps there are, who's involved, and what they're worth. How can the CFTC limit the share of the market one firm can control when no one knows how big the market really is? "That market is completely dark to us,"


Gary Gensler

Limiting the Speculators

As oil, wheat, and other commodity prices surge, the Commodity Futures Trading Commission is trying to find a way to clamp down on speculators. The commission voted on Jan. 13 to seek comment on a proposal to limit the number of contracts that speculators can own, whether traded on an exchange or in the over-the-counter swaps market.
—*Asjylyn Loder*

There are 2 kinds of oil contracts:

Futures are exchange-traded contracts for 1,000 barrels of light, sweet crude. They settle financially or with physical delivery of oil.

Swaps are unregulated contracts tied to the futures price of oil and settle financially.

Spot Months

The CFTC proposal would limit a firm's speculative holdings in spot month contracts—those nearest to expiration—which for oil is currently the March contract expiring Feb. 22. In the last three trading days before expiration, a firm would be capped at 25 percent of "deliverable supply," which the agency will determine. Aim: Discourage big market positions that can cause price gyrations.

Non-Spot Months

A firm with contracts for April and beyond could hold far more than in the spot month. How much depends on the total number of outstanding contracts, known as "open interest."

The First 25,000
For the first 25,000 outstanding contracts, a firm could own up to 2,500, or 10 percent of open interest.

Beyond 25,000
A firm could hold 2.5 percent of the remaining open interest. So if that were 750,000 contracts, it could hold 18,750 of them, or about 19 million barrels of oil.

ANDREW HARRER/BLOOMBERG; OPPOSITE PAGE: PHOTO-ILLUSTRATION BY EMILY KEEGIN; ALAMY; JUPITERIMAGES/GETTY IMAGES

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says Scott D. O'Malia, the newest CFTC commissioner and one of two Republicans on the five-member panel. Getting that information from banks, hedge funds, and refineries is tough, he says.

Limiting speculators has been hotly debated since 2008, when oil hit a record $147.27 a barrel. Gensler helped secure his confirmation to lead the agency in May 2009 by pledging to combat "excessive speculation." His dilemma: Democratic senators want a crackdown, but House Republicans don't and can retaliate by cutting his budget, which Gensler wants Congress to increase to $261 million from $169 million. Much of the increase would go toward hiring 400 more people to implement the Dodd-Frank law. Already, Representative Spencer Bachus (R-Ala.), the new chairman of the House Financial Services Committee, warned the CFTC in a Dec. 16 letter to avoid setting overly prescriptive speculation limits that might force firms to reduce their commodity investments. Speculators have become "scapegoats" for rising prices, says Terry Duffy, executive chairman of CME Group, owner of the New York Mercantile Exchange where oil contracts trade. "The fundamentals will always dictate what the price should be," he says.

To win political support, the CFTC's Jan. 13 proposal is modest, says trading consultant Beutel. The regulator estimated that its proposed caps on spot month contracts–the nearest delivery month–would affect only 40 energy traders a year. Limits on futures and swaps in all other months beyond the spot month would affect just 10 traders. The agency counted 418 large oil traders in the week ended Jan. 4, and 175 in natural gas.

Gensler might not have the three votes needed to impose even those limits. Democratic Commissioner Michael V. Dunn, whose term expires in June, may be the swing vote. At the Jan. 13 meeting, Dunn said there's no "reliable economic analysis" that proves excessive speculation is affecting markets. "My fear is that, at best, position limits are a cure for a disease that does not exist," Dunn said. "Or at worst, a placebo for one that does." —*Asjylyn Loder and Silla Brush*

The bottom line *The CFTC's push to limit commodity speculation faces opposition from House Republicans who now share control over the agency's budget.*

Higher Education

California Universities Feel the Squeeze

▸ Governor Brown's cuts imperil the tech industry's job incubator

▸ "It's ass-backwards, it's upside-down, it's stupid"

California's role as the incubator of talent that powers Silicon Valley and Hollywood owes much to a university system that has produced 56 Nobel Prize winners. Now, as Governor Jerry Brown tackles a crippling deficit, his plan to slash higher education spending by 16 percent



is raising concerns that the state may be jeopardizing the future of its high-tech and entertainment industries–and by extension the country's growth.

From the University of California, Berkeley, ranked the nation's top public university by *U.S. News & World Report*, to San Jose State University, which each year graduates more than 1,000 engineering students, the state's 33 public institutions are the birthplaces of companies and the sources of upward mobility for 650,000 students. That talent pool may be limited if the university system can no longer guarantee admission to the top 12.5 percent academic performers of California's high school seniors, and applicants are deterred as annual tuition for residents, less than $4,500 a decade ago, rises to at least $11,124 in the next school year. Mitch Kapor, founder and chief executive officer of Lotus Development, who invests in technology startups, says Brown's proposed cuts could have a lasting effect on the vitality of a state that's home to 14 percent of the companies in the Standard & Poor's 500-stock index, including **Google**, **Apple**, and **Walt Disney**. "Failing to continue to support the public higher ed system in California will have devastating long-term consequences," Kapor says.

Trimming the state's $25.4 billion deficit by cutting university budgets could make California's fiscal situation worse by stifling job creation and reducing the tax base, says Robert R. Ackerman, managing director of Allegis Capital, a Palo Alto (Calif.) firm that invests in computer networking and software companies. "It's ass-backwards, it's upside-down, it's stupid," he says. "We're reducing the ability to create the next generation that is going to create the jobs that [are] going to pay the pension obligations that this state has."

California, which aims to reduce its costs by $1.4 billion, isn't alone. Florida lowered its general revenue spending for 28 public colleges and 11 universities by 14 percent over the past three years. Funding in 2010 for the State University of New York, a system of 64 colleges and universities, fell $355 million, to $8.09 billion, for the fiscal year ending in March. Those cuts will reverberate, says Jeffrey R. Immelt, chairman and CEO of General Electric. "We hire thousands of college grads in the U.S.," Immelt said at the Consumer Electronics Show in Las Vegas on Jan. 7. "That, for us, is our lifeblood."

The spending cuts also pose a threat to America's ability to com-

pete in the global economy. China has identified seven universities that it will fund at a higher rate and aims to elevate Peking University and Tsinghua University into the top 20 in the world, according to a 2010 article in *Foreign Affairs* magazine by Yale University President Richard C. Levin.

To educate its growing population, India needs 600 more universities and 35,000 additional colleges, Human Resources Minister Kapil Sibal said in November. The country is seeking foreign universities to partner with Indian institutions and has attracted interest from Duke University, Boston University, and Georgia Institute of Technology. "Right now, if I were the Chinese university system, I'd be running ads showing up on UC's websites, recruiting students to universities in Beijing and Shanghai," Ackerman says. —*Oliver Staley*

The bottom line *Plans by California to reduce higher education spending by $1.4 billion could backfire long term by cutting job growth and tax revenue.*

Health Reform

The Doctors in the House Have an Agenda

▶ **The U.S. House has 15 Republican physicians**

▶ **The cost-cutting panel is "the most destructive" aspect of the law**

House members of the GOP Doctors Caucus at a 2009 hearing on health-care overhaul



The Republican Doctors

The House GOP Doctors Caucus numbers 18 members, including two dentists and a psychologist

Name/State	Degree	Occupation
Charles Boustany /LA	MD	Surgeon
Michael Burgess /TX	MD	Obstetrician
Paul Broun /GA	MD	Physician
Bill Cassidy /LA	MD	Physician
John Fleming /LA	MD	Physician
Phil Gingrey /GA	MD	Obstetrician
Tim Murphy /PA	PhD	Psychologist
Ron Paul /TX	MD	Obstetrician
Tom Price /GA	MD	Surgeon
Phil Roe /TN	MD	Obstetrician
Mike Simpson /ID	DDS	Dentist
Paul Gosar /AZ	DDS	Dentist
Larry Bucshon /IN	MD	Surgeon
Andy Harris /MD	MD	Anesthesiologist
Dan Benishek /MI	MD	Surgeon
Joe Heck /NV	DO	Physician
Nan Hayworth /NY	MD	Ophthalmologist
Scott DesJarlais /TN	MD	Physician

The symbolic House vote on Jan. 19 to repeal the health-care reform law was a tightly scripted set piece. It won't fly in the Senate, but Republicans aren't backing down and will soon begin the real work of trying to dismantle President Barack Obama's signature achievement.

Leading the charge will be a growing number of Republican doctors in Congress. These physicians-turned-lawmakers are looking to eliminate or diminish the power of a cost-cutting board that the Congressional Budget Office says could slash $15 billion from Medicare, the federal health program for the elderly and disabled, through 2019. The law allows the 15-member Independent Payment Advisory Board to make cuts in payments to physicians and drug companies as early as 2014. Hospital payments can't be targeted until after 2019. The GOP doctors view that as a threat to physicians' wallets and professional independence, and are pressing to roll back the law. They now number 15, up from 9 before the midterm elections. The House GOP Doctors Caucus also includes two dentists and is co-chaired by a psychologist, Representative Tim Murphy of Pennsylvania, and an obstetrician, Representative Phil Gingrey of Georgia.

The payment advisory board's authority is immense: To meet a spending target, it can cut whatever it chooses as long as it doesn't ration care, raise premiums, or increase co-payments. Congress can't override its decisions without finding offsetting reductions. White House officials led by Peter Orszag, the former budget director, singled the board out as one of the most important cost-reduction parts of the law. Perhaps more than any other provision, the panel could reduce the income of Medicare providers.

The panel—its members, appointed by the President, haven't been named yet—is "the most destructive" aspect of the law, says Representative Tom Price (R-Ga.), an orthopedic surgeon, because it will serve as a de facto "rationing board" for the federal government. "I know from talking with some of the doctors in Congress, there's deep concern" says Representative Charles Boustany (R-La.), a cardiovascular surgeon.

The Pharmaceutical Research and Manufacturers of America, the drugmakers' lobby, has also made the board's elimination its top priority. Last year, Republicans criticized drugmakers for striking an agreement with the Obama Administration. The companies offered $80 billion in discounts and refunds over 10 years to help pay for the law. The concessions may have insulated the pharmaceutical industry from tough new rules or price controls even as the bargain angered Republicans. Michael Steel, a spokesman for House Speaker John Boehner, recently called the arrangement a "backroom deal" that led to bigger profits for drug companies. House Republicans will put all that behind them, says Gingrey. "In this business, you have no permanent friends and no permanent enemies," he says.

The physician members plan to seek hearings on the cost-cutting board and push for its elimination. Representative Phil Roe (R-Tenn.), an obstetrician, intends to propose a measure soon to repeal the board outright.

Democratic senators are likely to resist undermining the Medicare board. Senators Jay Rockefeller (W.Va.) and Max Baucus (Mont.), the chairman of the Finance Committee, last year argued for the board's inclusion in the final version of the overhaul legislation, despite concerns it would weaken Congress's authority over Medicare and set the program up for steep payment cuts.

For that reason, Richard Tarplin, founder of Tarplin Strategies, a Washington (D.C.) consulting firm on health care and other issues, says repeal of the board is a long shot, although "there will be opportunity" to refine it. Among the possibilities: strengthening Congress's ability to avert any cuts the board recommends, and making allowances for increased Medicare spending in an emergency. —*Anna Edney*

The bottom line *Republican physician-lawmakers want to dismantle a Medicare cost-cutting board that could hit doctors in their wallets.*

SCOTT J. FERRELL/CONGRESSIONAL QUARTERLY/GETTY IMAGES; OPPOSITE PAGE: BLOOMBERG (3); AP PHOTO

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EMC: Square —and very profitable page 33 ▶

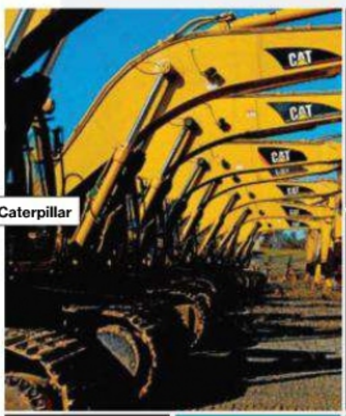


Corporate Taxes

The Multinational Advantage

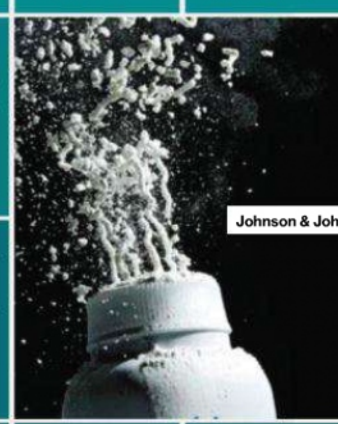
As President Barack Obama considers overhauling corporate taxes, big companies complain that the U.S.'s 35 percent top rate is one of the highest levies in the world. They also note that America, unlike most industrial economies, taxes corporate income earned abroad. But a University of North Carolina study of U.S. multinationals' effective tax rates–what companies paid from 2003 to 2007, after credits and deductions and sometimes shifting profits to low-tax jurisdictions–shows the differences are not that great. U.S. multinationals paid 26 percent on average, slightly more than the global average of 25 percent. Companies without major overseas units, such as retailers, often have higher effective rates. —*Peter Cohn and Matthew Caminiti*

Effective tax rates, in percentages, averaged over 2005-2009

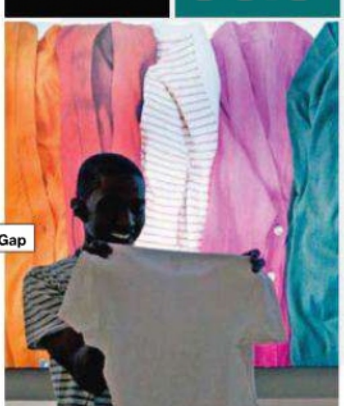


Caterpillar

Sector	Company	Country	Rate
Industrial and Heavy Machinery	Siemens	Germany	29
	United Technologies	U.S.	27.5
	Caterpillar	U.S.	24.7
	Hyundai Heavy Industries	South Korea	24.2
	General Electric	U.S.	11.5
Pharmaceuticals	AstraZeneca	Britain	29.5
	Johnson & Johnson	U.S.	22.8
	Bayer	Germany	20
	Pfizer	U.S.	18.7
	Sanofi-Aventis	France	18.2
Technology	SAP	Germany	31
	Apple	U.S.	28.5
	Microsoft	U.S.	26.7
	Nokia	Finland	23.9
	Cisco Systems	U.S.	21.6
Financial Services*	Wells Fargo	U.S.	30.9
	Royal Bank of Canada	Canada	24.7
	Bank of America	U.S.	24.7
	Deutsche Bank	Germany	24.2
	HSBC	Britain	20.6
Energy	Chevron	U.S.	43.9
	ExxonMobil	U.S.	41.7
	BP	Britain	33.8
	Petrobras	Brazil	30.2
	Petrochina	China	24.7
Retailers	Gap	U.S.	38.6
	Home Depot	U.S.	36.7
	Costco	U.S.	36.3
	Carrefour	France	32
	Inditex	Spain	23.5



Johnson & Johnson



Gap

DATA: BLOOMBERG; COMPANY REPORTS

*SOME U.S. FINANCIAL COMPANIES RECEIVED TEMPORARY TAX ALLOWANCES AFTER THE FINANCIAL CRISIS, RESULTING IN UNUSUALLY LOW RATES FOR 2008 AND 2009

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Technology

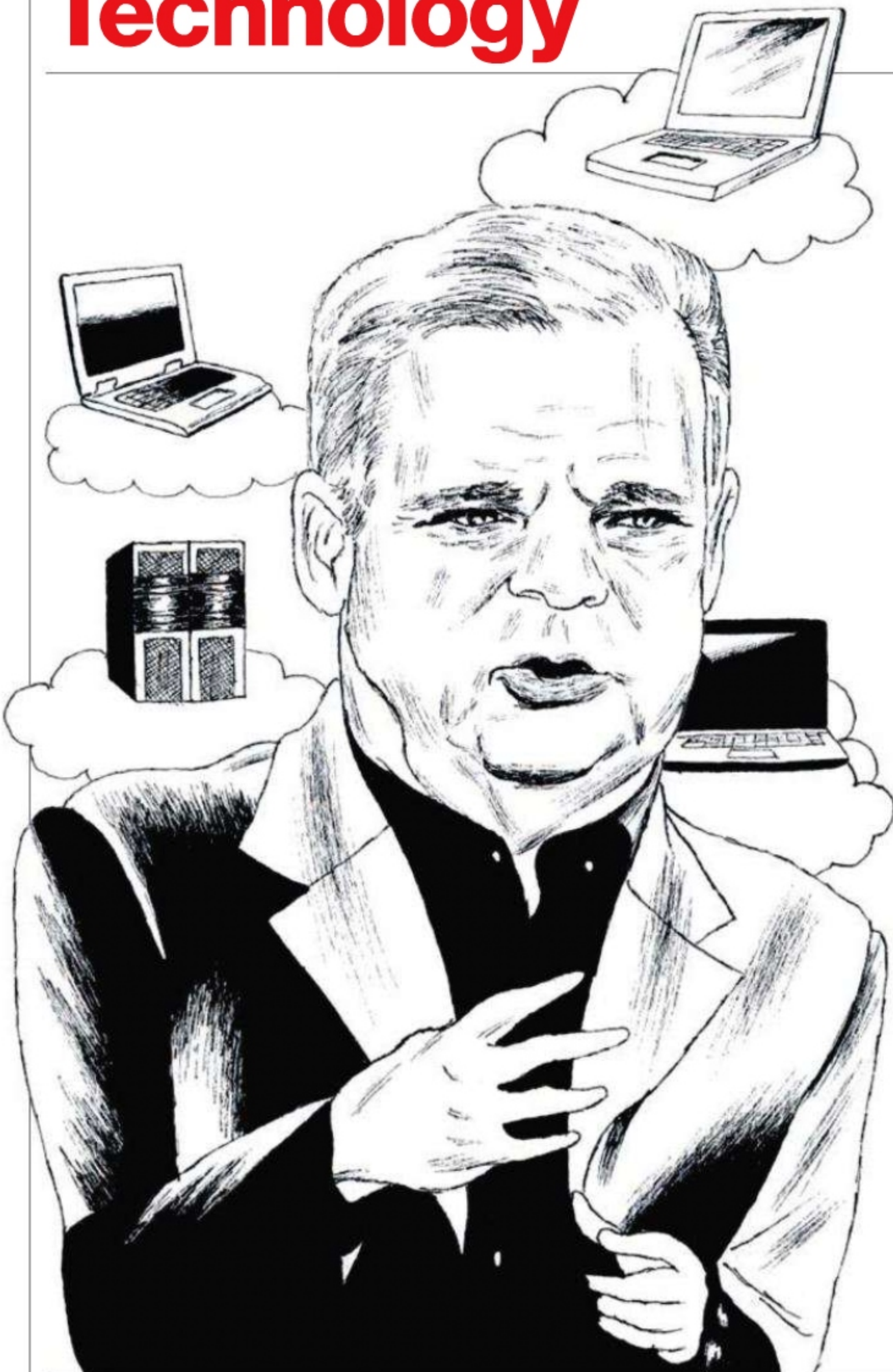


ILLUSTRATION BY ANDY FRIEDMAN

EMC Wants R-E-S-P-E-C-T

▶ A storage provider says it deserves more from Wall Street

▶ "Who am I to second-guess the market?" says CEO Tucci

At a Jan. 18 event to unveil 41 new computer-storage and software products, **EMC** made history. Twenty-six people—mostly women in revealing white unitards—walked onto a stage in New York City and crammed themselves into a Mini Cooper, setting a Guinness world record. Later, via a video feed from Miami, the stuntman Bubba Blackwell jumped his motorcycle over 40 of EMC's refrigerator-sized storage systems. The takeaway from the contorted bodies and the flying Harley was meant to be the "record-breaking performance" of EMC's products. Underlying that message, though, was EMC's desire for more attention, maybe even some love and respect, from its customers and investors.

$50bn
EMC's market capitalization as of Jan. 19

EMC executives say that outsiders fail to grasp the magnitude of the company's turnaround. EMC flew high during the 1990s, when it became synonymous with the Internet build-out and ended the decade as the New York Stock Exchange's best performer. Then it crashed hard following the dot-com bust, as corporate tech buyers turned away from the company's pricey, specialized storage system. EMC looked like it was heading toward an ugly, drawn-out demise.

Thanks to dozens of acquisitions over the past few years, EMC has undergone a radical, if quiet, transformation. Where it once relied on a single hardware product—the Symmetrix storage array, essentially a black cabinet full of hard drives—for more than 80 percent of its sales, EMC now gets about 60 percent of its revenue from software and services, estimates Toni Sacconaghi, an analyst with Sanford C. Bernstein. This shift has occurred under the stewardship of Joseph M. Tucci, EMC's chief executive officer, who has set the company's sights on the booming market for cloud computing. Despite the shift, EMC's share price has languished for much of Tucci's tenure. "There are times you get frustrated," Tucci says. "But who am I to second-guess the market?"

80%
EMC's ownership stake in VMware

Tucci, a New York native who says he's wanted to be a Fortune 500 CEO since he was a teenager,

never embraced the showmanship that many of his peers—particularly in Silicon Valley—bring to the job. While he gave a brief speech at the Jan. 18 event, Tucci spent most of his time offstage with customers. "Joe is an unassuming guy," says Kevin B. Rollins, the former CEO of **Dell**. One consequence of his reserve is that many have overlooked EMC's shift in focus. "I think they get underestimated," says Rollins.

Tucci became CEO in 2001. Bad timing: Sales plummeted in 2002, and EMC cut its staff from 24,500 to 17,000. When business stabilized, Tucci began expanding beyond storage. He pushed engineers to develop a broader portfolio of products, bought a pair of data-management software companies, and, in late 2003, acquired **VMware** for $625 million in cash. That startup made so-called virtualization software, technology that saves companies on capital and energy costs by letting them run multiple operating systems and software applications on one server.

In 2003, the VMware price tag appeared staggering. The virtualization market was small and, worse, **Microsoft** was coming out with its own, cheaper virtualization products. The VMware purchase has since turned out to be one of the all-time savvy buys in tech. The company, now 80 percent owned by EMC, dominates the virtualization market, had $2 billion in revenue last year, and is valued at $39 billion.

Since nabbing VMware, EMC has

> **"There's a litany of hardware companies that have fallen by the wayside because they didn't evolve"**

snapped up a host of companies that put it in position to not just store customers' data but also to secure it, back it up, and analyze it. Bernstein's Sacconaghi says hardware companies like EMC rarely get a second act. "There's a litany of hardware-centric companies that have fallen by the wayside because they didn't evolve," he says. "But EMC very methodically, purposefully, and skillfully migrated the portfolio."

Investors have been cool toward EMC's turnaround story in recent years, although the company's shares have gained in the last two years alongside a broader stock market recovery. Sacconaghi notes that EMC has "become somewhat dependent" on cash-devouring acquisitions for growth. Some investors struggle with how to properly value what is essentially two companies in one. EMC is a slower-growing technology veteran but one that derives much of its worth from VMware, a growth stock. Roughly 60 percent of EMC's $50 billion market capitalization comes from its stake in VMware, which some major EMC investors think is overheated. "I think on a standalone basis VMware is probably overvalued," says Jeff Donlon, the managing director of the technology group at Manning & Napier Advisors. Donlon's firm was one of EMC's top 10 shareholders two years ago but has been selling the stock as both EMC and VMware have risen. Still, Donlon credits Tucci with securing "a bunch of crown jewels" and giving the company a shot at a bright future.

As a reward for his hard work, Tucci has earned the chance to pit EMC and its close to $17 billion in annual revenue against a formidable club of larger rivals, including **Hewlett-Packard**, **IBM**, **Oracle**, and Dell. These companies are colliding as they transition from specialists to one-stop-shops that can provide the core technology as businesses shift to the cloud. The re-focusing by Tucci, 63, was intended to prepare his company for exactly this type of battle. "Do I think there will be very big companies that fail or disappoint greatly here?" he asks. "Yes. You just have to have the conviction and be strong enough in your own belief and keep pushing."

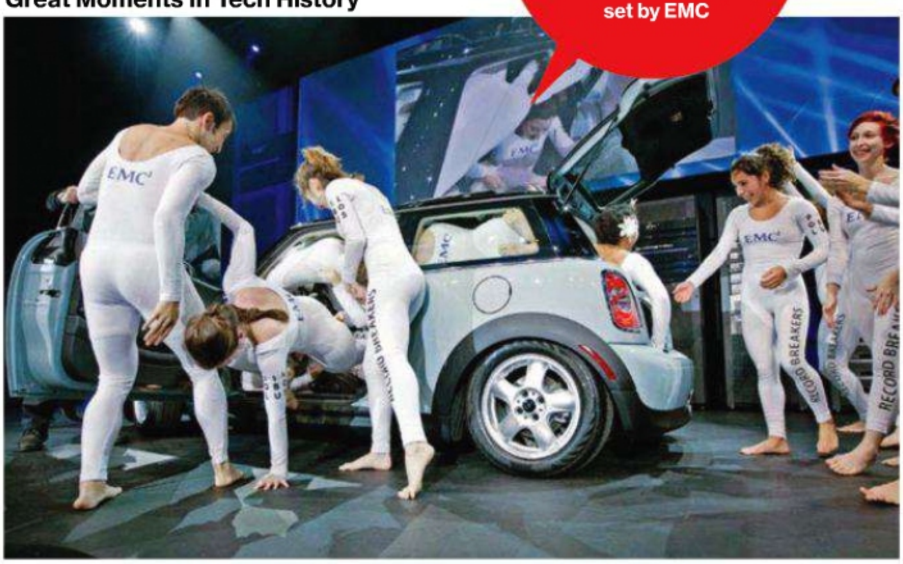
The Mini Cooper and Harley stunts underscore EMC's new, more aggressive marketing approach as it tries to remain among the living. Last year, EMC hired Jeremy Burton, a former Oracle executive known as a savvy seller of complex technology, as its chief marketing officer. Burton's challenge is to communicate that EMC has moved beyond its long-standing reputation as an expensive storage shop. "When people are sick of seeing our ads and start stabbing themselves with blunt instruments, you have to run them for another two years and then perceptions will change," Burton says.

The silver-haired Tucci plans to remain in the background, away from the marketing extravaganza. He's found an unusual niche: a tech CEO whose ego doesn't need feeding from an adoring public. As Scott McNealy, the former CEO of **Sun Microsystems**, puts it: "Joe is weird because he's not weird."
—*Ashlee Vance*

***The bottom line** Acquisitions have made EMC a one-stop-shop for cloud computing needs. Wall Street, so far, remains unimpressed.*

Great Moments In Tech History

26
The world record for number of people who fit into a Mini Cooper, set by EMC



FROM TOP: MATT NAGER/BLOOMBERG; JIN LEE/BLOOMBERG; ILLUSTRATION BY MATT OWENS

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Homebuilders: Squeezing out the small fry page 42 ▶



E-Commerce

Creating Web Addicts For $10,000 a Month

▶ To boost business, consultants add game elements to humdrum sites

▶ "We're in the middle of an arms race for fun"

Rajat Paharia is a new breed of business consultant. For a monthly fee he promises to invigorate stale websites by turning them into video games. Visitors become players. If they perform certain tasks, such as commenting on articles or e-mailing links to friends, they earn points or badges. Paharia's company, San Jose-based startup **Bunchball**, has performed more than 50 online makeovers for **NBC**, **Playboy**, and other large websites. "Our customers don't want to be game designers," says Paharia, 40. "They just want more page views."

Video game designers have spent the last few decades perfecting the art of making their products addictive. Now traditional companies are building loyalty for their websites using so-called gamification techniques. Tactics such as leader boards, which encourage users to compete against one another for points, are becoming common across the Web. "We're in the middle of an arms race for fun," says Gabe Zichermann, an entrepreneur who is organizing the first Gamification Summit (scheduled for Jan. 20 and 21 in San Francisco), developing a certification course for gamification experts, and writing a book on the subject.

Bunchball, **Badgeville**, and other game consultancies charge clients as much as $10,000 a month to bring game features to their sites. Industry revenues will total $1.6 billion by 2015, up from less than $100 million last year, estimates M2 Research, a gaming and technology researcher based in Encinitas, Calif.

The business of engendering online loyalty through gaming techniques is fast becoming as significant as the real-world loyalty industry, which builds rewards programs for airlines, hotels, and credit cards. The difference is that real rewards, like free hotel rooms and airfare, cost businesses real money. Badges and leader boards, excluding fees to consultants like Paharia, cost next to nothing.

It's a neat trick–if it lasts. "People move in herd mentality," says Tim Chang, partner at venture capital firm **Norwest Ventures**. "The backlash is going to come from people who try to slap [game features on a site] without any understanding of how to bake it into the full experience."

When done right, games exert a strong psychological influence over consumers, says Amy Jo Kim, a game designer who worked on hits such as Rock Band after earning a PhD in behavioral neuroscience. "What games do is help you come up with stories about yourself," she says. Earning points or reaching new levels creates the illusion of progress and is akin to "telling you a story about yourself getting better and stronger and more powerful," she says.

Social status is another motivator. "We have this tendency to care about what image we portray," says Dan Ariely, a professor of behavioral economics at Duke University. In real life, there are mansions and handbags. "In the gaming world," says Ariely, "there are badges."

The techniques behind gamification are known in the business as "game mechanics," and they're everywhere. Countdown clocks on **Gilt Groupe**, a discount luxury goods site, impel shoppers to nab deals before time runs out. Colorful virtual badges, such as those on Foursquare, a smartphone app that lets people "check in" to venues, reward frequent use of a site or service. When **LinkedIn** members log in they're shown a progress bar, subtly urging them to add more details to their profiles.

At Bunchball, 28 employees perfect the fictitious currencies, cutesy avatars, and other elements required to gamify websites. Last April, Paharia met with New York-based food ordering website **Campusfood.com**, which wanted to increase the likelihood of a first-time user returning to the site. Paharia built a feature that rewards repeat customers with whimsical badges such as Raw Deal (10 sushi orders in a month) and Beta Taster (one of the first 50 people to order from a new menu). Since adding points and badges to Campusfood.com, the number of new users who return two or more times is up 15 percent to 20 percent, says Michael Saunders, the site's founder.

Moxsie, a website that sells clothing from independent fash-

Game Mechanics 101:
How websites use tactics honed in video games to increase page views and sales

Countdown	Appointments	Badges & Trophies	Leaderboard	Progress Bar
Users earn access to special offers or features that expire after a short time	Sites dole out rewards to users who return at a predetermined time	Users get quirky, colorful emblems for performing specific actions	Sites award points for completing tasks and rank high-scoring users	Sites display a gauge that subtly urges users to complete specified tasks
On the Web: Sales at discount luxury goods retailer **Gilt Groupe** usually last 36 hours. The ticking clock creates a sense of urgency in shoppers	**On the Web:** American Express cardholders can receive special deals by visiting the site **Daily Wish** at specified times three days a week	**On the Web:** The location-based smartphone app **Foursquare** gives out a "Fresh Brew" badge after users visit 30 coffee shops	**On the Web:** At **Philly.com**, the *Philadelphia Inquirer*'s homepage, visitors earn points for viewing and sharing articles. High scorers appear in a "Top Fans" feature	**On the Web:** The progress bar on **LinkedIn**, a social networking site for professionals, encourages new members to fill out their profiles and work histories

worldmags

ion designers, uses game mechanics to encourage customer feedback. It awards virtual ranks—such as "senior buyer" or "guru"—to users who help the company's clothing buyers decide which items to stock. Built by consultants at Badgeville, the ranking system helps "leverage our community to make sure we get trend information from the ground level," says Jon Fahrner, the entrepreneur who launched Palo Alto-based Moxsie in 2009.

The practice of gamification is rubbing off on the real-world loyalty industry, too. Barry Kirk, director of strategic consulting for **Maritz**, manages loyalty programs for Bank of America, **Capital One**, and other brands. One of his clients, **Hilton**'s Embassy Suites brand, has been piloting an online game designed to encourage existing customers to try out new hotels. "Game designers have created these amazingly compelling strategies," says Kirk. "Why wouldn't we adopt those approaches?"

—*Douglas MacMillan*

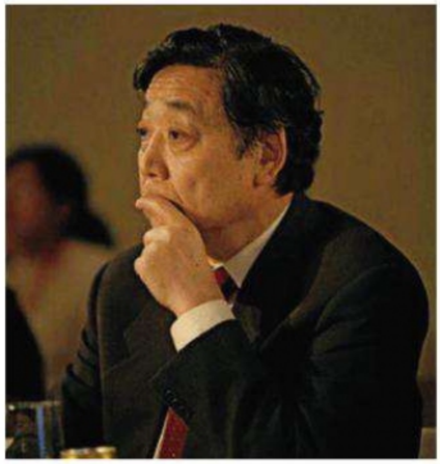
The bottom line *"Gamification," a trendy technique for building addictive Web destinations, has raised the number of return visitors at some sites by 20 percent.*

Semiconductors

A First for China's Chip Giant: Profits

▶ **Under a new CEO, SMIC may be closing in on profitability**

▶ **"We're driving on the freeway at the same time we're repairing the car"**



"We are almost boiling," says CEO Wang. "We just need a little bit [more] heat"

China's factories are working nonstop to churn out smartphones, digital cameras, and other silicon-based gadgets, but that hasn't translated into profits for China's biggest chipmaker. Since its first plant opened in 2002, Shanghai-based **Semiconductor Manufacturing International** has lost $1.66 billion. Even in 2010, as the foundry industry (which makes semiconductors on a contract basis for chip-design clients) was on the upswing and rivals had to turn away customers, SMIC fared poorly. It is expected to lose $67.5 million for the year, according to a Bloomberg survey of analyst estimates.

That's changing, says David N.K. Wang, the company's chief executive officer. SMIC reported earnings of $30.4 million for the third quarter, its second consecutive quarterly profit. "We are almost boiling," says Wang. "We just need a little bit [more] heat."

A turnaround at SMIC could help China finally become a player in the global semiconductor industry, now dominated by **Intel**, **Samsung Electronics**, and Taiwanese foundries. China has many young chip-design companies that have difficulty getting high-profile manufacturers to build semiconductors, since chipmakers often reserve capacity for more established companies such as **Qualcomm** and **Nvidia**. SMIC is supposed to fill the void. "Its sole purpose is not necessarily to make money," says Michael Clendenin, managing director of Shanghai-based RedTech Advisors. Chinese policymakers look to SMIC "to provide wafers to companies that wouldn't otherwise get them," he says.

Some SMIC investors nonetheless expect the company to turn a profit once in a while. "From a commercial point of view," says Clendenin, "it's a glorious failure." Running semiconductor fabrication plants is enormously expensive: They cost billions of dollars to build. Since SMIC's technology isn't as advanced as that of rivals such as **Taiwan Semiconductor Manufacturing** (TSMC), the world's largest foundry, SMIC can't produce chips as cheaply. That puts it at a big disadvantage.

Wang took over in November 2009, at the company's nadir—shortly before SMIC had to pay $338 million in cash and shares to TSMC to settle a trade-secrets lawsuit. (The company admitted no wrongdoing.) Wang has spent the past year focusing on boosting SMIC's chipmaking technology, which lagged several generations behind that of its competitors. He's shifting toward narrower circuit widths, which command higher prices; such chips accounted for 8 percent of revenue in the fourth quarter of 2010 but will be "at least 40 percent" of sales a year from now, he says. He has also overhauled top management, recruiting executives who have worked at Intel, TSMC, and other companies. "We're driving on the freeway at the same time we're repairing the car," he says.

The China-born Wang, who spent 25 years working at **Applied Materials**, the world's top producer of chipmaking equipment, is "very, very focused on delivering the numbers and executing," says Steven Pelayo, regional head of technology in Hong Kong for HSBC Securities. The transformation has been so complete, "The company should have just changed its name."

The Chinese government has chipped in, too: State-owned **Datang Telecom Technology & Industry**, which paid $172 million in 2008 for 16.6 percent of SMIC, reported in November that it had increased its stake to 19.1 percent. As China's leaders start to promote domestic consumption, sales of electronics should increase, says William Chou, managing partner with Deloitte in Beijing. That should mean more business for SMIC. The company lacks

➜



The Shanghai headquarters of SMIC, China's largest chipmaker

TOP: LIANG ZI/IMAGINECHINA







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"cutting-edge technology, but they are closer to the market," he says.

Others doubt SMIC will benefit from that growth. The industry is already crowded with bigger, richer foreign companies, including Abu Dhabi's **Globalfoundries**, which plans to double spending to $5.4 billion on plants and equipment this year. SMIC's Hong Kong-listed shares have slumped 76 percent since its 2004 initial public offering. "The winners have won, and it's going to be tremendously expensive to change the game," says Bill Wiseman, managing partner of McKinsey's Taiwan office.

Still, Wang reminds the skeptics that things are on the upswing. Analysts expect the company to earn a small profit this year, $16.7 million on sales of $1.66 billion. "For the enterprise to grow, you have to make money," he says. "That's what was missing."

—*Bruce Einhorn*

The bottom line *SMIC is China's biggest chip manufacturer and, historically, a big money loser. A new CEO says a turnaround is in progress.*

Gaming

Nintendo Brings 3D to The Really Small Screen

▶ Its $250 portable game device goes on sale in late March

▶ If it doesn't match sales of the DS, "we would consider it a failure"

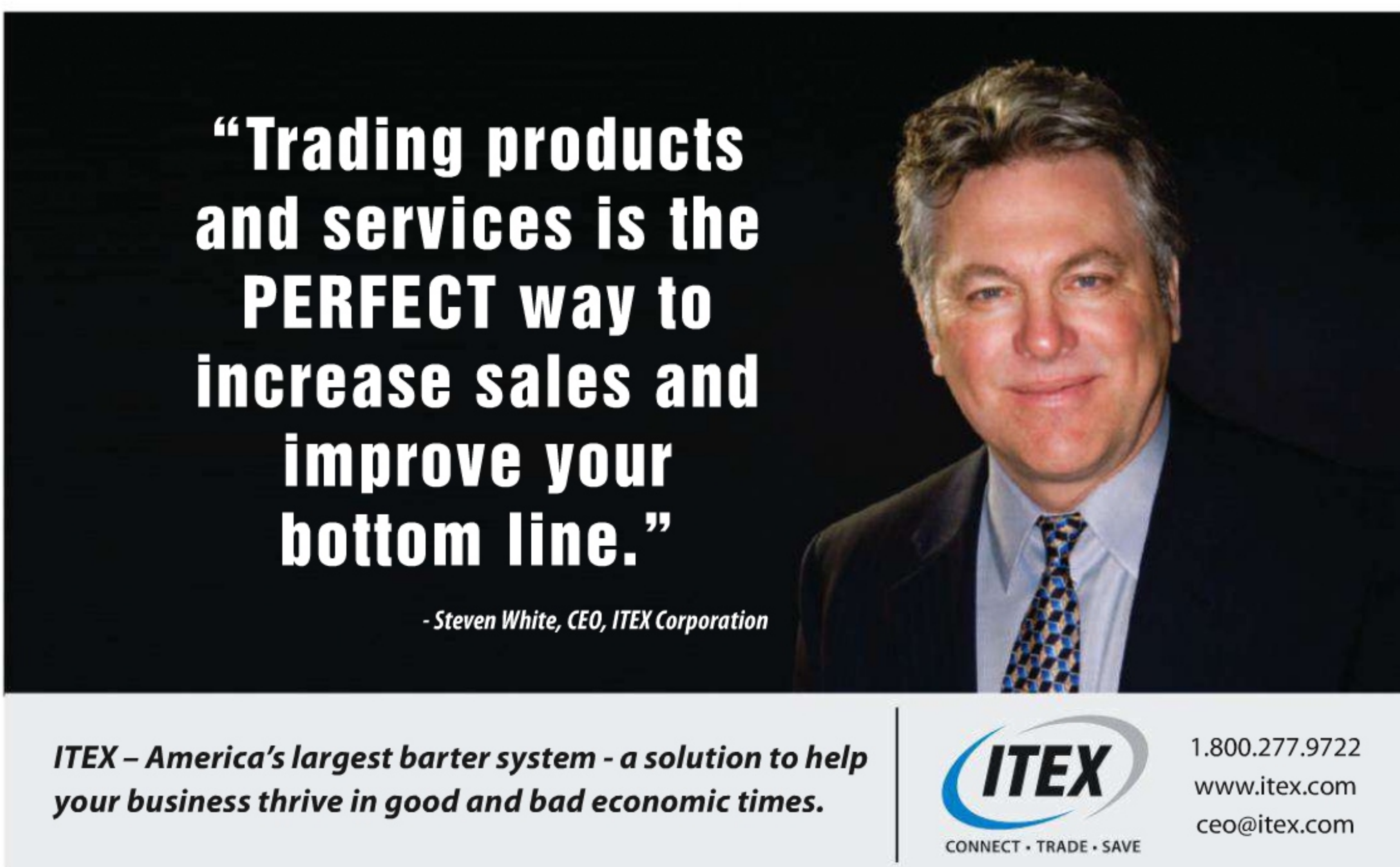
For 122 years, **Nintendo** has been all about the game. After dominating Japanese card games, it moved on to toys, coin-op arcades, and finally video games, creating memorable characters named Mario, Pikachu, Zelda, and Donkey Kong.

Satoru Iwata, Nintendo's current president, is trying to keep the streak from ending. On Mar. 27, the Kyoto-based company will begin selling a $250 device in the U.S. called the Nintendo 3DS, the first portable game console to show three-dimensional images without the need for special glasses. Until recently, the company relied on the Nintendo DS and newer DSi to dominate the portable business. They accounted last year for 57 percent of Nintendo's hardware sales (the company also sells the Wii game console) and 79 percent of $1.7 billion in U.S. portable sales, according to researcher NPD Group. However, the popularity of those handhelds has slipped since last April, and Nintendo, which began working on the 3DS two years ago, could use another hit. "This will have to be a platform that is at least as well accepted as the DS, or we would consider it a failure," Iwata said in an interview on Jan. 9.


Satoru Iwata

Nintendo faces new competitive threats. **Sony** as early as Jan. 27 will announce it's working on a new version of its PlayStation Portable, and follow that with a game-play-

FROM LEFT: MIKE NELSON/EPA/LANDOV; PHOTOGRAPH BY KATJA HEINEMANN FOR BLOOMBERG BUSINESSWEEK



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ing phone in February, according to two people familiar with the company's plans. **Sharp** and **LG** this year will sell their own glasses-free 3D smartphones that can play games. **Apple** is winning over developers with its pitch that iPhone, iPad, and iPod touch offer the best in casual games.

Nintendo tried to master 3D technology 15 years ago with its Virtual Boy 3D headgear, introduced in 1995 and discontinued a year later. The new device creates a 3D effect by alternately flashing images to the left and right eye. (Some gamers in Japan have become dizzy playing the 3DS; the company warns that children under six should avoid playing it because of potential eye problems.) A slider on the handheld can make the effect more intense or shut it off. The 3DS costs 67 percent more than the $150 DSi and its games may cost twice as much. It has only half the battery life. "The features of 3DS have to be tried; they don't lend themselves to traditional marketing media such as TV and Internet," Iwata says.

Nintendo hopes to offer Hollywood movies and content from **ESPN**, the **NBA**, and **NFL** on the 3DS as early as this year. The player will also come bundled with cards that, when placed on a table and used with the device's rear-facing camera, generate games or other events on the screen with the real world as the backdrop.

"Nothing [else] is going to deliver 3D videogames, 3D video, and 3D photography all in the same package," says Nintendo of America President Reggie Fils-Aime. Nintendo has been heavily courting **Activision** and **Electronic Arts** to create exclusive 3DS games that take advantage of the device's fast processing and improved graphics. About 30 games will be available before June. Iwata says the company learned its lesson after a dearth of non-Nintendo games for the original DS got sales off to a slow start. So far, most developers are choosing to offer versions of existing games rather than devoting resources to new properties. "We are watching closely how it is received by consumers," says John Schappert, Electronic Arts' chief operating officer.
—Cliff Edwards and Pavel Alpeyev

The bottom line *With competition intensifying in portable games, Nintendo hopes to set itself apart with its new 3DS handheld device.*

Innovator

Evan Ratliff



The magazine writer has developed software that gives small publishers the chance to compete with moguls on tablets and smartphones

New York City's borough of Brooklyn has become a hot spot for artisanal crazes, including beer brewing and pickling. Now, Brooklyn is set to give rise to the ultimate in 2011 bespoke craftsmanship: artisanal iPad publishing.

On Jan. 26, Evan Ratliff, a 35-year-old magazine writer, will launch The Atavist, a boutique publishing venture that will sell original, long-form nonfiction stories exclusively on smartphones and tablets. Ratliff will commission and edit the stories, which will be longer than typical magazine features and shorter than most books. Readers will be able to download the Atavist app for free and purchase individual stories for $2.99 on iPhones and iPads, or pay $1.99 for a Kindle version. Writers will earn a flat fee for each story plus a percentage of every copy sold.

The logistics of publishing on tablets and smartphones with different screen sizes and operating systems is a major challenge, says Ratliff, the son of a logistics professor at Georgia Institute of Technology. The Atavist has built a content management system, dubbed Periodic Technology, that allows editors to build multimedia narratives, design layouts, and then, with one step, publish across multiple platforms. It currently formats content for iPhones, iPads, and Kindles, and will soon serve Android devices as well.

To date, tablet-only publishing has been the playground of the rich; billionaires Rupert Murdoch and Richard Branson are launching tablet ventures. Ratliff plans to license his technology and lower the barrier to entry for small publishers. He hasn't set the license fee yet but says it will be cheaper for indie publishers than creating an app from scratch. "This is a very easy way for small publishers to start doing this," says Ratliff. "You don't have to have millions of dollars."

"Right now everyone is starting from scratch and has to solve the same problems over and over again," says Robin Sloan, a Twitter employee who is writing a novel. "It's a waste of everybody's effort. The fact that they are thinking about the platform behind it distinguishes them from other folks. We desperately need tools."

Ratliff created The Atavist with Nicholas Thompson, a senior editor at *The New Yorker*, and Jefferson Rabb, a programmer and Web designer. The idea originated in the fall of 2009. Ratliff had just written a multimedia series for *Wired* about the challenge of shedding your identity in the Digital Age. The series documented his efforts to disappear and the effort by *Wired* readers to find him and claim a $5,000 reward. Afterward, Ratliff and Thompson, then his editor at *Wired*, met for a drink. The iPad was just a rumor, but both writers were already excited by the possibilities for multimedia storytelling, says Ratliff. "If you create something that a lot of people like, it costs almost nothing to deliver it to a potentially huge group of people." *—Felix Gillette*

Past Feat ▶ Tried to shed his identity for a popular *Wired* article

Goal ▶ Getting device users to pay for long-form nonfiction

Technology ▶ Software that formats articles for several gadgets at once

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Can You Profit from Panic in the Muni Market?

▶ As investors flee, some analysts say predictions of widespread defaults are overblown

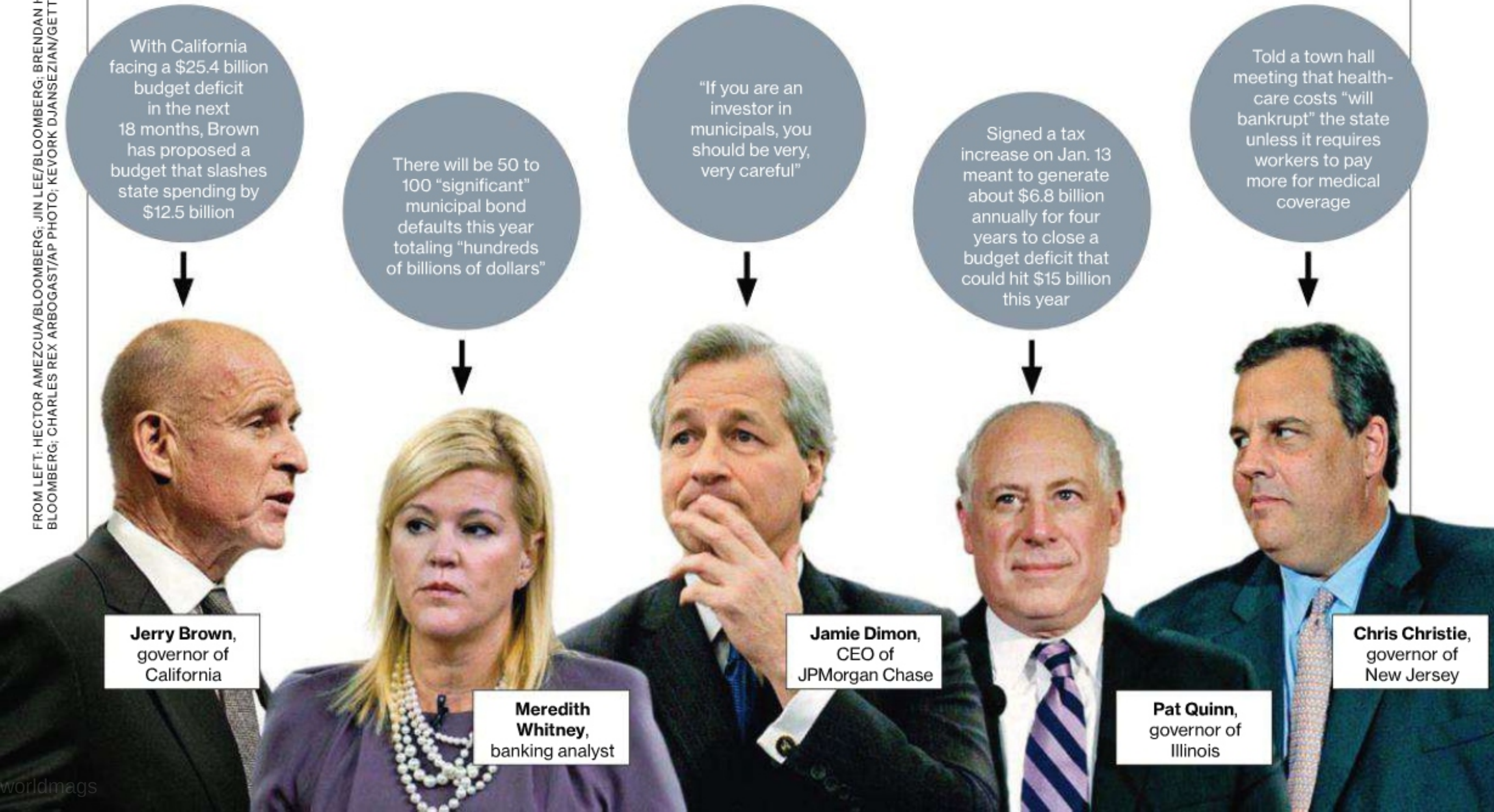
▶ "Sky-is-falling reports... are lacking in evidence"

Tom Kozlik, a municipal bond analyst for Philadelphia brokerage **Janney Montgomery Scott**, sent clients a note on Jan. 14 reminding them of Warren Buffett's advice for navigating market turmoil: Be greedy when others are fearful. There's been plenty of fear in the $2.9 trillion U.S. state and local government bond market, typically a safe haven for individuals seeking tax-free returns and little risk of default. With states facing budget deficits estimated at as much as $140 billion and cities reeling from tax revenue lost during the housing market bust, some are calling that safety into doubt.

Meredith Whitney, the banking analyst who won fame for predicting that **Citigroup** would be forced to cut its dividend in 2008, says she expects as many as 100 municipal defaults this year, adding up to "hundreds of billions" in debt. On Jan. 11, Edmund F. Kelly, chief executive officer of insurer **Liberty Mutual**, said his firm has cut its holdings of municipal debt in Connecticut, California, and Illinois, three states that are heavily indebted and strapped for cash, saying the market was being propped up by the belief that Washington will bail out local governments. **JPMorgan Chase** CEO Jamie Dimon, speaking at a health-care conference on Jan. 11, warned of municipal bankruptcies on the horizon, cautioning investors in the market to be "very, very careful."

Investors pulled money from mutual funds that buy municipal securities for nine straight weeks through Jan. 12. Those withdrawals helped drive returns on muni bonds down 4.5 percent during the final three months of 2010, the worst quarterly return since the beginning of 1994, according to **Bank of America Merrill Lynch**'s index. This year the slide is continuing. The average muni yield, which moves in the opposite direction of price, jumped to 5.39 percent last week, the highest since the depths of the financial crisis in December 2008. When the New Jersey Economic Development Authority tapped the market on Jan. 13, the size of the deal was cut back by nearly half the original offer because of the high interest rates muni investors were demanding. That same day, Governor Chris Christie warned that health-care costs for workers threatened to "bankrupt" the state.

Christopher J. Mier, municipal bond strategist for Chicago investment bank **Loop Capital Markets**, says



FROM LEFT: HECTOR AMEZCUA/BLOOMBERG; JIN LEE/BLOOMBERG; BRENDAN HOFFMAN/BLOOMBERG; CHARLES REX ARBOGAST/AP PHOTO; KEVORK DJANSEZIAN/GETTY IMAGES

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muni bond investors have been rattled by their losses and are shifting money back to the stock market, where prices have been rising as the economy stabilizes. "You've got a big asset reallocation going on here," he says.

Bill Gross, who manages **Pimco Total Return**, the world's biggest mutual fund, told Bloomberg Television on Jan. 12 that he doubted there will be many municipal bankruptcies. Christopher Hoene, director of research at the National League of Cities in Washington, says only four cities and counties have defaulted since 1970. "The overwhelming preponderance of local governments respond by cutting spending or raising other revenues, not by defaulting on debt," he says. "The bottom line is that sky-is-falling reports about the muni market are lacking in evidence."

There are some signs that municipal finances are beginning to mend. State and local government tax revenue rose 5.2 percent during the third quarter, according to the U.S. Census Bureau, marking the fourth consecutive increase. Deutsche Bank's analysts wrote on Jan. 14 that spending by U.S. states and localities during the third quarter point to a turnaround. And in Illinois, one of the states where the fiscal crisis has been most pronounced, Governor Pat Quinn signed a bill on Jan. 13 raising the state income tax rate to 5 percent—a 67 percent jump. On Jan. 10, California Governor Jerry Brown submitted an $84.6 billion budget that cuts spending by $12.5 billion.

Not all of the price declines hitting muni bonds stem from worries about defaults. In December, Congress and President Barack Obama agreed to extend all the Bush-era income tax cuts. Lower tax rates reduce the allure of tax-free bonds. Washington also allowed the Build America Bond program—which lavished subsidies on localities that sold taxable bonds—to lapse at the beginning of this year. With the subsidies no longer available, local officials will need to turn to the traditional municipal market, potentially increasing the supply of bonds. JPMorgan analysts estimate tax-exempt sales could jump to $325 billion this year, from $285 billion in 2010. "That's going to put pressure on the market for sure," says Chris Holmes, an analyst with JPMorgan.

The rout may prove to be a buying opportunity for intrepid investors, according to some analysts. "We have to say, here and now, that a generic long-dated AAA-rated muni yielding just over 5 percent is pretty juicy," wrote David Rosenberg, chief economist at investment firm **Gluskin Sheff + Associates**, in a Jan. 14 note. The yield on a top-rated, 30-year tax-exempt bond, now 5.2 percent, is the equivalent of 8 percent for a buyer in the top 35 percent tax bracket, according to Janney Montgomery. That's almost twice the yield on U.S. Treasuries. Says Janney's Kozlik: "Savvy municipal bond investors should be greedy when others are fearful, just as Warren Buffett advises, and scoop up bonds at bargain prices." —*William Selway*

The bottom line *Fiscal distress has set off fears of defaults in the muni bond market. Some analysts see a buying opportunity for the brave.*



David Rosenberg, chief economist, Gluskin Sheff

"Orange County defaulted 16 years ago, and believe it or not, the creditors were ultimately made good"

3.96

PERCENTAGE POINTS

The spread between two-year and 30-year Treasury yields on Jan. 15, a record. The gap reflects investors' concerns about inflation as the economy strengthens.

DATA: BLOOMBERG

Housing

Amid the Ruins, Big Homebuilders Gain

▶ **Access to funding helps larger companies grab market share**

▶ **"The small and medium-size builder has been blown up"**

With competitors driven out of business by the recession and sales likely to climb from record lows, the biggest U.S. homebuilders are poised to benefit from a rebound in demand for new houses this year. **D.R. Horton**, **Lennar**, and **Toll Brothers** are among companies planning to boost the number of developments where they are selling homes by at least 10 percent in 2011 after buying land at discounted prices and obtaining financing unavailable to smaller builders.

Bigger builders have a decided advantage in the slump, says Tony Avila, chief executive officer of **Avila Advisors**, a San Francisco investment-banking firm that specializes in the homebuilding industry. Smaller builders are having trouble raising money to buy land or build homes because lenders have tightened their credit requirements and remain bearish on housing, he says.

Toll Brothers, the largest U.S. luxury-home builder, expects to gain market share without entering new areas, CEO Douglas C. Yearley Jr. says. In the Philadelphia area, near the Horsham (Pa.) company's headquarters, eight of the 10 builders that competed in the luxury segment have gone out of business. "Every recession, the bigger builders have gained market share," says Yearley. "The small and medium-size builder has been blown up. I'm not saying they never come back, but they have no credit. They're damaged goods."

The National Association of Home Builders expects new single-family home sales to rise to 405,000 this year, while Moody's Analytics projects an increase to 540,000. Either figure would represent a big jump from the past two years. In 2009, sales of new single-family properties totaled 375,000 units, the lowest figure in records dating to 1963. For the first 11 months of last year, sales ran at an

CLOCKWISE FROM LEFT: MERRILL LYNCH & CO./BLOOMBERG; HULTON ARCHIVE/GETTY IMAGES; MATT NAGER/BLOOMBERG



Green lessons from ancient Rome page 73 ▶



Toll Brothers has seen smaller competitors go out of business

annual pace of 319,640, Commerce Dept. data show. Home prices are down 30 percent from their July 2006 peak, according to the S&P/Case-Shiller index. Values probably will fall an additional 6 percent before the traditional spring selling season begins, Standard & Poor's said in a Jan. 10 report.

Washington, D.C., is an example of a metropolitan area where big builders are boosting share, says Brad Hunter, chief economist of Metrostudy, a Houston firm that tracks housing starts. The five largest builders in northern Virginia–**NVR**, Toll Brothers, **Ryland Group**, **PulteGroup**, and **Centex Homes**, a Pulte affiliate–accounted for 46 percent of 6,775 new-home starts in the third quarter of 2010, up from 38 percent in the third quarter of 2006, when ground was broken on 16,934 houses. "They increase market share 3 percent to 5 percent in every downturn," says Debbie Rosenstein, principal of Fulton Research, a real estate firm in Fairfax, Va. "It increases every time because they have access to money."

Homebuilding stocks are already reflecting the optimistic outlook. The S&P index of 12 homebuilding companies climbed 30 percent from Nov. 30 to Jan. 18, compared with a 9.7 percent increase in the S&P 500-stock index. In 2010 the homebuilder gauge rose 2.3 percent, less than the 13 percent gain for the S&P 500.

Ivy Zelman, CEO of Cleveland-based advisory firm Zelman & Associates, who rated all homebuilders "sell" in December 2006, now has "buy" ratings on five of the 13 companies she covers: **KB Home**, Lennar, **Meritage Homes**, NVR, and Ryland.

NVR, which builds in 14 states under Ryan Homes and other brands, has the best prospects, according to Zelman and Carl Reichardt, an analyst with Wells Fargo Securities. Since 2008, NVR has entered markets such as Indianapolis and Columbus, Ohio, where it faces little competition from other public companies, says Reichardt. "We think that the company is building homes at a lower cost per foot than many of its peers," he says. "That could in turn lead to additional share gain." *—John Gittelsohn*

The bottom line *Access to funding—and less competition—will help big homebuilders gain market share as home sales begin to recover this year.*

Investment Banking

A Tech Dealmaker Mounts a Comeback

▶ **Frank Quattrone is climbing the rankings in Silicon Valley mergers**

▶ **He "has one of the best networks" in the industry**

Silicon Valley's go-to banker is back. Frank Quattrone, who became a star during the 1990s' dot-com boom by bringing public more than 175 companies, including **Amazon.com** and **Cisco Systems**, is grabbing market share from big Wall Street banks less than three years after starting his own firm.

Qatalyst Partners, founded in March 2008, catapulted to 10th place among financial advisers for technology mergers and acquisitions last year, ahead of **Citigroup** and rival boutiques **Greenhill** and **Evercore Partners**, data compiled by Bloomberg show. The San Francisco firm, which didn't appear in the 2009 M&A ranking, has already scored its first deal of

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2011, advising home-networking chipmaker **Atheros Communications** in its $3.2 billion sale to fellow chip manufacturer **Qualcomm** on Jan. 5. "Qatalyst is filling the void created by the volatility of the technology sector and the entire generation of bankers who left the industry during the financial crisis," says Chris Varelas, a partner at Menlo Park (Calif.) private equity firm Riverwood Capital, who was Citigroup's head of telecom, media, and technology investment banking until 2008.

Quattrone, 55, started Qatalyst six months before the bankruptcy of Lehman Brothers in September 2008. Before that he spent five years on the sidelines in legal battles with securities regulators. He was exonerated on appeal, and the matter doesn't appear to have made a dent in his relationships with the top players in tech. "Frank has one of the best networks and expertise in the technology industry," says Larry Sonsini, chairman and co-founder of Wilson, Sonsini, Goodrich & Rosati, a Silicon Valley law firm that worked on $17 billion in technology deals last year, according to Bloomberg data.

Sonsini and Quattrone collaborated in August when they helped sell **3Par** to **Hewlett-Packard** for $2.35 billion—a deal value that skyrocketed after an 18-day bidding war with Dell more than tripled the purchase price. They teamed up again in November when they, along with **Morgan Stanley**, advised video-storage provider **Isilon Systems** in its $2.25 billion sale to **EMC**.



Quattrone's firm ranked 10th among tech merger advisers last year

The deals have placed Quattrone back at the center of the industry he dominated as a banker for **Credit Suisse Group**. He left Credit Suisse in 2003 to fight allegations that he hindered an investigation into charges that the bank demanded kickbacks from hedge funds that profited from IPOs. Three years later the government agreed to drop all charges after he won an appeal of his conviction for obstruction of justice. "His success proves that there are plenty of third acts on Wall Street," says William D. Cohan, a Bloomberg Television contributor and former investment banker. "I'm not in the least bit surprised of his comeback in this environment where the tech machine hype is building again."

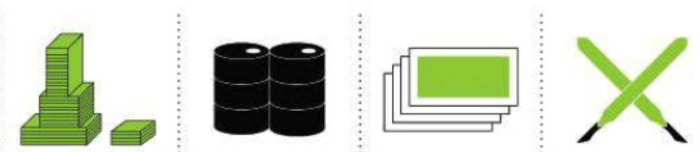
Qatalyst Group isn't a one-man show. Last April, Quattrone brought in George Boutros, his former deputy from Credit Suisse, as senior partner. At the same time he recruited Jason DiLullo, another managing director from Credit Suisse. Quattrone declined to be interviewed for this story. Appearing at the Web 2.0 Summit in San Francisco in November, in an apparent pitch for his services, he said that for company founders looking to cash out, mergers can be more lucrative than initial public offerings. Unlike a full-service investment bank, Qatalyst can't underwrite an IPO. —*Serena Saitto*

The bottom line *His legal troubles behind him, Quattrone is reestablishing himself as a leading Silicon Valley dealmaker.*

Compensation

Banks Are Still Where the Money Is

Wall Streeters discouraged by declining bonuses this year can take solace: They still earn much more than brain surgeons, top lawyers, and four-star generals. —*Danielle Kucera and Christine Harper*



Occupation	M&A banker	Bank oil trader	Corporate bond trader	Neurosurgeon
Experience	10 years	10 years	10 years	8 to 17 years
Annual Pay	$2,000,000	$1,000,000	$1,000,000	$571,000



Law firm partner	Four-star general	Cancer researcher	Aerospace engineer	Architect
10 years	34+ years	10 years	5 to 10 years	10 years
$600,000	$185,000	$110,000 to $160,000	$100,000	$80,000 to $100,000

DATA: JEANNE BRANTHOVER, BOYDEN GLOBAL EXECUTIVE SEARCH; GEORGE STEIN, COMMODITY TALENT; ROB D'ANGELO, OLESKY ASSOCIATES; JEFFREY LOWE, MAJOR, LINDSEY & AFRICA; TOM LAROCK, DEFENSE FINANCE AND ACCOUNTING SERVICE; RICK HENNESSEY, COMMONWEALTH SCIENCES; PETER BOHNER, MARYMONT GROUP

Oil Stocks

After the Spill, Small Drillers Are Merger Bait

▶ With costs rising, many may find it hard to stay independent

▶ "The industry will increasingly rely on larger companies"

Two years ago, **Seahawk Drilling** was plotting to expand its fleet of rigs worldwide. Now that **BP**'s well explosion in the Gulf of Mexico has thrust the industry into a regulatory limbo, Houston-based Seahawk may sell itself. "If we can't be more diversified, I would rather sell the company to somebody else and let them try to do it," says Seahawk Chief Executive Officer Randall Stilley.

Mergers and acquisitions among offshore drillers are likely to accelerate as bulk becomes a matter of survival in an industry that Simmons analyst Ian Macpherson now pegs at $125 billion in size. Intensifying government scrutiny and rising customer demands may crank up costs so high that only the largest companies can compete, bankers and analysts say. There were $5.3 billion worth of deals involving drillers last

FROM LEFT: PAUL SAKUMA/AP PHOTO; ILLUSTRATION BY MATT DORFMAN; TOM WILLIAMS/ROLL CALL/GETTY IMAGES

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year, more than triple the total in 2009, data compiled by Bloomberg show. "What you have to do these days to get a contract if you're a driller is going to get tougher and tougher," says Mark Bentley, who advises on energy mergers and acquisitions at Greenhill in London. "This means the industry will increasingly rely on larger companies."

Oil giants **ExxonMobil**, **Chevron**, and **Royal Dutch Shell** are demanding that drillers have the highest-quality equipment and the most experienced rig workers, says Global Hunter Securities analyst Brian Uhlmer. Meanwhile, U.S. regulators still refuse to issue permits in the Gulf of Mexico, and the Interior Dept. is returning applications with requests for more details about how the companies are meeting environmental and equipment rules imposed by the government since the April BP disaster.

That's put a squeeze on drillers. "The drillers have to scrap, upgrade, and modify because of environmental concerns and to meet new requirements," says Bjarne Skeie, who last year sold his stake in **Skeie Drilling & Production** to Houston-based **Rowan**.

"New regulations, stricter permitting/certification procedures, and higher insurance costs could push small-caps with limited operating experience into the arms of stronger players," Citigroup analyst Robin Shoemaker wrote in a Jan. 11 report, which cited **Ensco** of London, Rowan, and Houston-based **Pride International** as potential targets. Ensco, with a market value of $7.7 billion, trades at 13 times earnings as of Jan. 18, while Rowan has a price-earnings ratio of 13.1, lower than the 14.5 average among drillers, Bloomberg data show. Rowan and Pride declined to comment. Ensco did not respond to requests for comment.

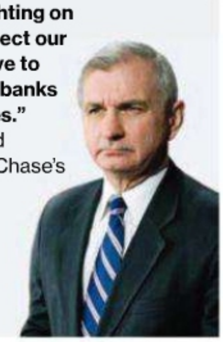
Other potential takeover targets include the drilling unit of Greece's **Metrostar Management** and Houston-based **Vantage Drilling**, says Uhlmer, who names **Transocean**, **Diamond Offshore Drilling**, and **Seadrill** as possible acquirers. Representatives for Metrostar, Vantage, Transocean, and Diamond Offshore declined to comment. Seadrill didn't respond to requests for comment.

Seadrill, controlled by Norwegian billionaire John Fredriksen, has been the most acquisitive driller since 2006, announcing 11 transactions worth $4.96 billion, according to Bloomberg data. The company, which has a market value of about $14.7 billion, agreed on Jan. 3 to buy two ultra-deepwater rigs from **Lloyds Banking Group** for $1.2 billion. *—David Wethe and Jacqueline Simmons*

The bottom line *With operating costs rising in the aftermath of the Gulf oil disaster, many smaller drillers will be acquired by larger companies.*

Quoted

"Soldiers who are fighting on the front lines to protect our country shouldn't have to needlessly fight with banks to protect their homes."
—Senator Jack Reed (D-R.I.) on JPMorgan Chase's admission that it wrongfully foreclosed on 14 military families



Mutual Funds

Pimco Takes a Step Toward Independence

▶ Bill Gross' company, owned by Allianz, sets up a sales unit

▶ "It looks like they're trying to control their own destiny"

Pacific Investment Management Co. may be seeking more independence from its parent, German insurer **Allianz**. Pimco, the largest U.S. asset manager owned by a bank or insurance company, is waiting for regulatory approval to open a broker-dealer to sell its funds in the U.S., says Douglas Hodge, chief operating officer of the Newport Beach (Calif.) money manager. The firm has designated 170 salespeople from Allianz to staff the new unit, to be called Pimco Investments.

Led by Bill Gross and Mohamed El-Erian, Pimco has seen assets climb to $1.2 trillion from $200 billion when Allianz acquired it in 2000. Much of the firm's growth has been fueled by Pimco Total Return, managed by Bill Gross, which is the world's largest mutual fund, with assets of $240 billion. Last year it opened its first actively managed stock mutual fund, Pimco EqS Pathfinder, which now has assets of $875 million. "The big issue is, as Pimco has grown, is the tail wagging the dog?" says Jeffrey Hopson, an analyst with Stifel Nicolaus in St. Louis. "They've set up their own equity business, and now it looks like they're trying to control their own destiny."

Some of the biggest firms sold their asset management units after the financial crisis, or are planning to do so. In 2009, London-based **Barclays** sold its Barclays Global Investors unit to **BlackRock**, now the world's largest asset management firm. **Société Générale**, based in Paris, said in 2009 that it planned to take its investment unit TCW Group public over the next five years.

"The history of the asset management business demonstrates time and time again that the most successful asset management firms are those [that] are dedicated to investing rather than subsidiaries of banks and insurance companies where there can be lots of tension," says Burton Greenwald, a fund consultant in Philadelphia. "Fund companies tend to be entrepreneurial, while banks and insurance companies tend to be bureaucratic."

Pimco Investments will be based in New York and run by Jon

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Short, who says he plans to hire about 80 more people to expand the distribution unit to 250. Pimco, co-founded by Gross in 1971, has maintained some autonomy since the takeover by Allianz, relying on its own investment and executive committees to control investment guidelines, expansion plans, and executive hires. The firm gives an undisclosed share of its income to Allianz. Pimco's relationship with Allianz will not change as a result of the new distribution arrangement, Hodge says. Allianz Global Investors, the Munich-based insurer's asset management unit, "fully supports" Pimco's mutual fund distribution in the U.S., says spokesman Hanno Strube.

Gross' Pimco Total Return Fund has doubled in size, to $240 billion, since mid-2008 as investors flocked to bond funds. The fund, which had about $30 billion in assets when Allianz acquired the firm, became the largest in mutual fund history in 2009, surpassing the $202.3 billion record set by Capital Group's Growth Fund of America in 2007.

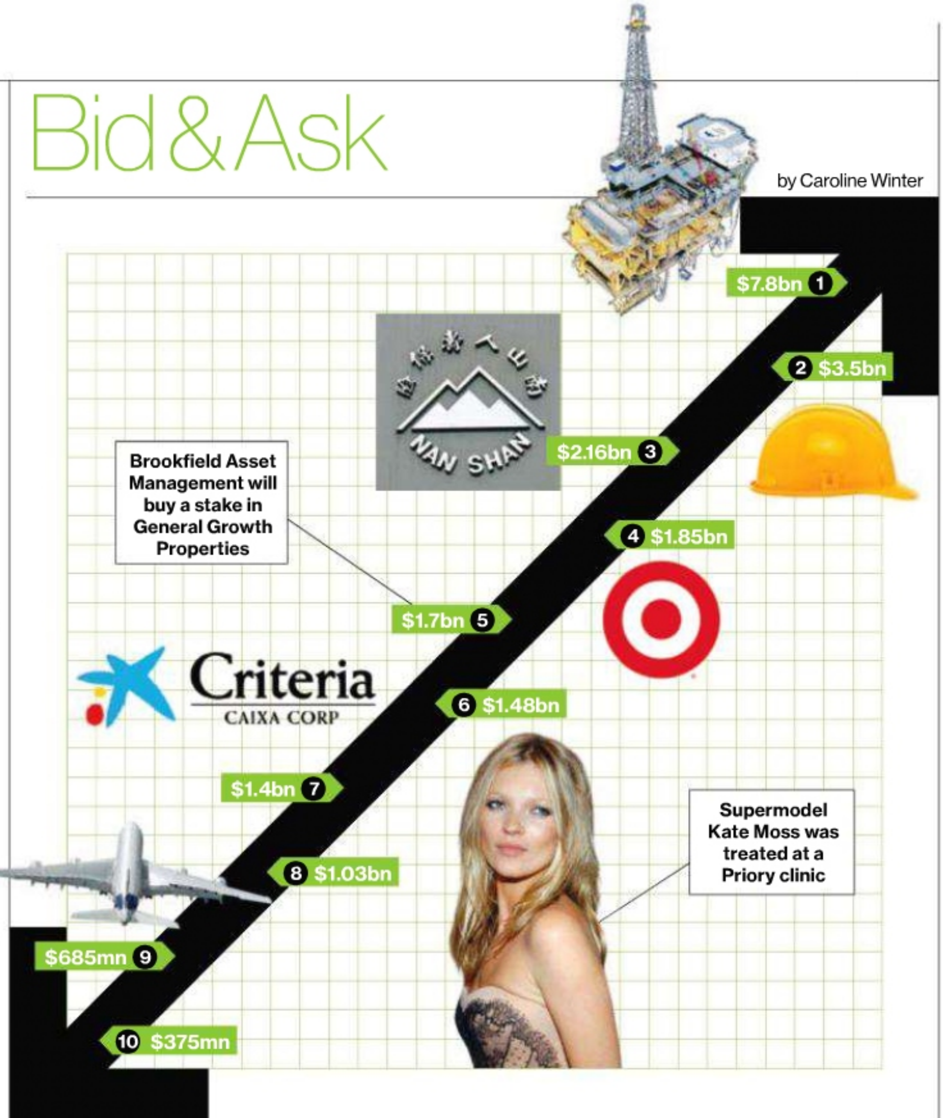
Gross, 66, said last year that he has no plans to retire. He received more than $200 million from Allianz for his stake in Pimco at the time of the takeover. He also got $200 million over a period of five years for agreeing to stay. El-Erian, 52, was named chief executive officer of Pimco in 2008 and, as part of Pimco's succession planning, shares the role of chief investment officer with Gross. A University of Oxford-trained economist who started his career at the International Monetary Fund, he was instrumental in formulating Pimco's "New Normal" philosophy, which predicts lower returns for bonds, slower economic growth in the U.S., and a bigger role in developing markets in the world economy. Reflecting that outlook, the firm has been diversifying. In 2009 it hired former U.S. Treasury official Neel Kashkari as head of new investment initiatives, along with Anne Gudefin and Charles Lahr from Franklin Resources to start EqS Pathfinder. Last year it hired Goldman Sachs' Maria Gordon to lead an emerging-markets group.

—Sree Vidya Bhaktavatsalam

The bottom line *Pimco is establishing its own mutual fund sales operation in a move that gives it increased independence from parent Allianz.*

Bid & Ask

by Caroline Winter



1 **BP** agreed to a share swap with Russian state oil producer Rosneft to build a strategic global alliance. BP will get a 9.5 percent stake in exchange for 5 percent of its shares, valued at $7.8 billion.

2 Texas-based construction giant **Fluor** won a contract valued at $3.5 billion to help build a liquefied natural gas project in Queensland state for Australian oil producer Santos.

3 **American International Group** agreed to sell Taipei-based Nan Shan Life Insurance to investors led by Ruentex Group for $2.16 billion.

4 **Target** will pay $1.85 billion for store leases in Canada, expanding outside the U.S. for the first time. It plans to open 100 to 150 stores there by 2014.

5 Investment firm **Fairholme Capital Management** will sell its stake in shopping mall owner General Growth Properties to Brookfield Asset Management for about $1.7 billion.

6 **Advent International** agreed to pay Royal Bank of Scotland $1.48 billion for Priory Group, a U.K. operator of mental health and addiction clinics that has treated celebrities such as Kate Moss.

7 Investment company **Criteria CaixaCorp** will sell 50 percent of its non-life-insurance unit VidaCaixa Adeslas to Spanish insurer Mutua Madrilena for $1.4 billion.

8 **Comerica**, the Dallas-based bank that posted annual profits throughout the financial crisis, will buy Houston-based lender Sterling Bancshares for roughly $1.03 billion in stock.

9 **Meggitt,** the U.K. maker of airplane-engine-monitoring systems, agreed to buy Pacific Scientific Aerospace from Danaher for $685 million to expand its range of firefighting products.

10 **Airbus** increased the list price of its A380 superjumbo by $29 million, to $375.3 million. The A380 had 240 orders from 18 customers as of Jan. 6. **B**

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Regulation Nation

The Obama Administration has stepped up the government's role in rulemaking and enforcement. Some businesses couldn't be happier

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Editor's Letter

Introducing Bloomberg Government

Imagine a product that quantifies the impact of legislative action, executive decisions, and policymaking on companies, industries, and markets with real-time context and perspective. That's Bloomberg Government, or BGov, a new online service by the people who brought unparalleled analysis, data, and news to financial markets.

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Inside this special section of *Bloomberg Businessweek*, we've assembled a sampling of the intelligence that BGov offers on its paid-subscription website. We've focused this package on the federal regulatory agenda for 2011 and beyond. We examine industries–health care, energy, defense, technology and telecommunications, finance, and transportation–as well as trade, taxation, and labor.

This array of smart stories and engaging graphics will give you a taste of Bloomberg Government's exclusive and original work, which is compelling content that you won't find anywhere else. BGov builds a bridge of understanding between Washington and Corporate America, which should help government and business do their important work better.

I invite you to peruse this section and then log on to Bloomberg Government. You'll find us on the Web at bgov.com.

Matthew Winkler
Editor-in-Chief, Bloomberg News

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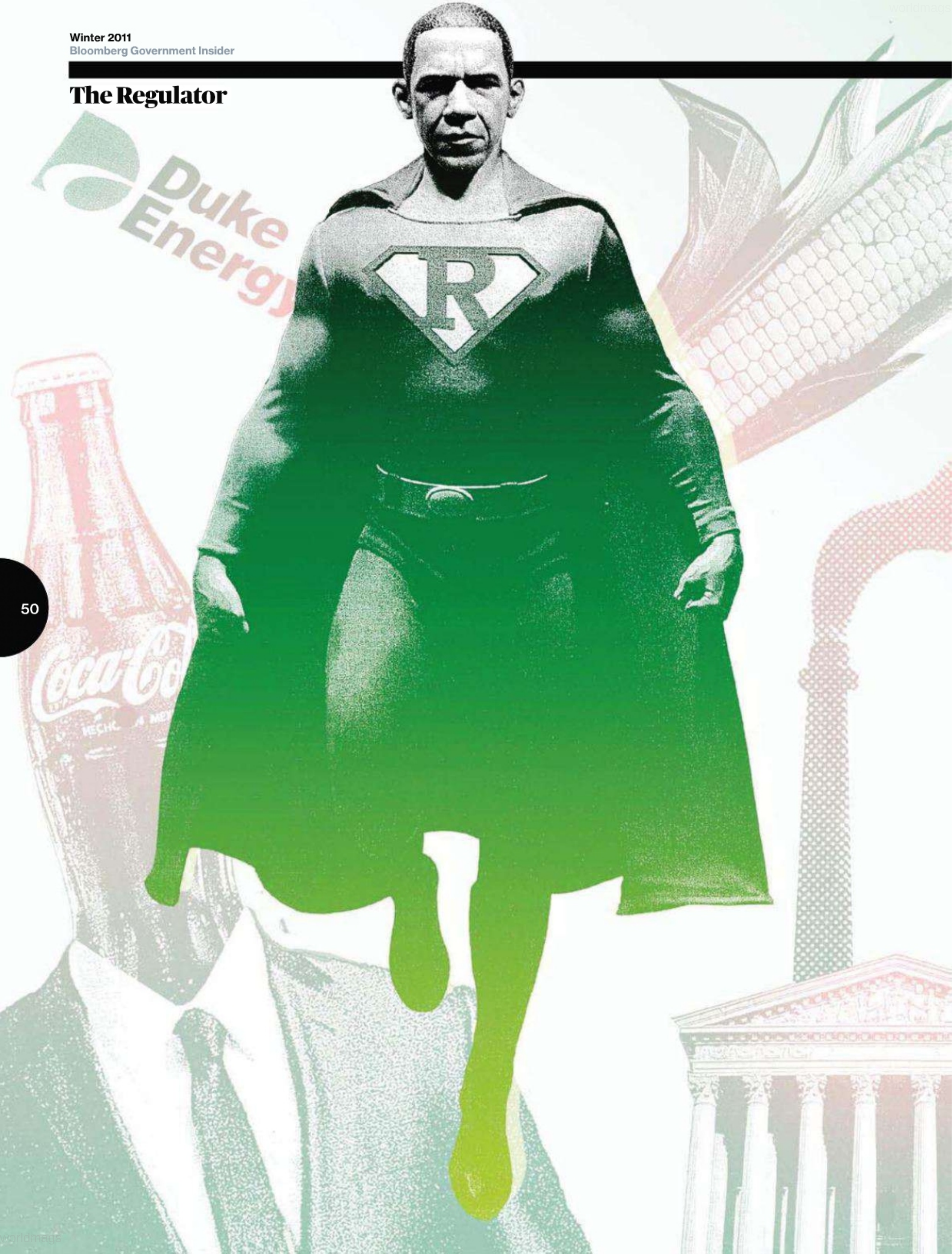
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The Regulator







The Regulator: Why Business Loves Rules

From Corn to Chemicals, Many Industries Are Thriving Under Obama's Reign of Rulemaking

(Really)

By David J. Lynch | Illustrations by Jimmy Turrell





The Regulator

The rolls of red tape spilling from landmark food safety legislation approved by Congress before Christmas represent precisely the sort of governmental intrusiveness that business detests. Mandatory reports. Nosy federal inspectors. Expansive government powers. So what do those affected say about Washington's latest brainstorm? "It's a present under the tree," says Scott Faber, vice-president for federal affairs at the Grocery Manufacturers Assn., which represents companies such as Coca-Cola and Del Monte Foods.

Foodmakers have reason to cheer. Following serial episodes of contaminated eggs, peanut butter, and spinach, sales slumped even for companies whose products weren't making people sick. To reassure consumers, manufacturers swallowed hard and sought the feds' seal of approval. All the government headaches will be worth the trouble if they calm shoppers and prevent costly recalls.

The food industry's embrace of government oversight illustrates an unacknowledged truth about the wary interaction between the public and private sectors. Executives complain about unelected bureaucrats complicating their lives and siphoning profits. Yet most large corporations long ago learned to live with regulation. Sometimes they even demand it. "Everyone thinks the business community hates regulations. Not only is that not true, it couldn't be further from the truth," says R. Bruce Josten, the U.S. Chamber of Commerce's top lobbyist.

For Dover's OPW Fueling Components division in Hamilton, Ohio, new regulations requiring service stations to minimize vapors from underground storage tanks have spurred millions of dollars in sales of specialized containers and valves since the rules were announced in 2008. OPW's domestic sales, which Dover does not disclose, rose 7 percent last year. Environmental regulations "can create, really, years of opportunity," says David Crouse, OPW's president.

Companies such as Archer Daniels Midland and Cargill are asking regulators to rename as "corn sugar" the oft-maligned sweetener known as "high-fructose corn syrup." Industrial consumers of electricity such as ExxonMobil, Dow Chemical, and Alcoa want Washington to re-regulate power markets. And utilities Duke Energy and PG&E last year backed climate change legislation to dispel the uncertainty complicating multibillion-dollar investments in new plants.

Says Tyson Slocum, energy director of the Washington (D.C.)-based advocacy group Public Citizen: "The kind of simplistic analysis you often see where it's business saying regulation is bad, vs. liberals or Democrats saying regulation is good, is not entirely accurate. Plenty of times, businesses are calling for regulation if it suits their business model."

President Barack Obama took office decrying his predecessor's deregulatory impulses, seeing in the financial crisis evidence that laissez-faire had failed. On Jan. 18 the President recalibrated, ordering government agencies to eliminate regulations that place "an unreasonable burden on business."

In theory, regulation protects the public and ethical businesses from companies that underpay workers, operate hazardous factories, pollute, and sell unsafe products.

In a Bloomberg poll in December, 70 percent said government regulation is needed "in most cases to protect the public interest" vs. just 25 percent who said it wasn't. And 53 percent of respondents agreed that "most American businesses" cannot be trusted to act in the public interest, vs. 41 percent who disagreed. Yet those surveyed also favored, by 52 percent to 38 percent, decreasing the amount of federal regulation.

On Obama's watch, regulators have been more aggressive. The Occupational Safety and Health Administration issued citations over the past two years for "willful violations" of federal workplace rules at a pace roughly six times that during the final year of George W. Bush's Administration, according to the nonprofit OMB Watch.

This is where the business community's desire for beneficial regulation ends and its allergy to decrees begins. In 2011, following last year's passage of major financial and health-care legislation, detailed rules affecting perhaps one-quarter of the nation's economy will be written. Making major investments amid so much uncertainty strikes apprehensive executives as excessively risky. The U.S. Chamber's Josten warns of an approaching "regulatory tsunami."

Writing new financial regulations will preoccupy at least three agencies. At the Federal Reserve, a 300-person team will produce roughly 100 rules, including those specifying how much capital banks must hold in reserve. Across town, officials at the Health and Human Services Dept. are drafting more than 40 regulations required to implement health-care reform. That work, the Congressional Research Service said in April, will go on "for years, or even decades to come."

With the Democrats no longer in control of the House of Representatives, the Administration is pursuing some policy aims via regulation rather than legislation. That foreshadows a clash with newly empowered Republicans, who vowed in their campaign "Pledge to America" to "rein in the red tape factory in Washington, D.C." by requiring a congressional vote on major new regulations.

One early flash point: the Environmental Protection Agency's plans to regulate utilities' greenhouse gas emissions. Coming after the Senate failed to act on climate change, the move has provoked Republican ire. "This Administration has perfected the art of governing by fiat through the regulatory process, which I think is an absolute abuse of power," Representative Tom Price (R-Ga.) told a December gathering at the American Enterprise Institute.

Executives at Babcock & Wilcox, the Charlotte-based maker of emissions-control systems for power plants, don't share the gloom. The company sees a $10 billion to $12 billion market for scrubbers that strip sulfur dioxide, nitrogen oxide, and





mercury from coal-fired plants. "We're starting to see some of that move forward," Chief Executive Officer Brandon C. Bethards told analysts on Nov. 9.

Republicans nonetheless will keep hammering away at regulations' cost. Exhibit A is a 2010 study by Mark and Nicole Crain, a husband-and-wife team of economists from Lafayette College in Easton, Pa., which pegged regulations' annual costs to business at $1.75 trillion—an amount larger than the Canadian economy. A narrower study by the Office of Management and Budget concluded that regulations' benefits far outweigh their costs.

Representative Darrell Issa (R-Calif.), the new chairman of the House Oversight and Government Reform Committee, worries that the "regulatory state" is strangling job growth. Issa last month solicited examples of job-killing rules from more than 150 companies, trade associations, and research groups ahead of planned hearings. Representative Jack Kingston (R-Ga.), who chairs the House subcommittee that monitors the Food and Drug Administration, derides "nanny-state politicians" and told Bloomberg News he would seek to trim the $1.4 billion needed to implement the food safety bill.

One man's nanny is another man's benefactor. Autoliv, the Stockholm-based maker of seat belts and air bags, said sales of its side-curtain air bags "will be driven" by stiffer U.S. safety regulations, which take effect in 2013. In the third quarter of 2010, Autoliv sold 7.3 million side-curtain air bags, up 40 percent from the same period in 2009.

The regulatory process offers business other opportunities. "There are two principal ways to make a better mousetrap: Make a better product or get the government to pass a regulation that hurts your competitor more than it hurts you," says Richard Williams, who spent 27 years writing regulations for the FDA.

After a 2004 academic journal article speculated that high-fructose corn syrup might be more fattening than sugar in products such as soft drinks and baked goods, some consumers began shunning the substance. Many scientists, including Michael Jacobson of the Center for Science in the Public Interest, say the processed sweetener is nutritionally no better or worse than sugar. Yet for the fiscal year that ended on Sept. 30, consumption of high-fructose corn syrup was down 13.3 percent from just four years earlier, says the Agriculture Dept. Among those switching some products to sugar were Kraft Foods, Starbucks, and PepsiCo. In May, ConAgra Foods' Hunt's brand said it changed its ketchup "in direct response to consumer demand."

A two-year "Sweet Surprise" ad campaign failed to arrest the slide. The Corn Refiners Assn. in September petitioned the FDA to give "high-fructose corn syrup" the more consumer-friendly moniker "corn sugar." CRA President Audrae Erickson says the request is aimed at clearing up confusion and is unrelated to declining sales. Jacobson notes that the industry "was perfectly happy with the term high-fructose corn syrup" until the obesity controversy erupted.

Some government rules also spawn unlikely alliances of self-interest, a phenomenon former Federal Trade Commission Executive Director Bruce Yandle once dubbed "bootleggers and Baptists," a reference to the polar opposites who backed Prohibition. In 2009, Duke Energy and PG&E joined their traditional foes in the environmental movement to support a proposed cap-and-trade program designed to limit greenhouse gas emissions. For utilities mulling multibillion-dollar investments in new plants, a uniform national standard beats the alternative: a mélange of state policies and EPA edicts.

Climate-change legislation died in mid-2010, leaving utilities to face EPA rules expected in July. Duke Energy is proceeding with two coal-fired plants while delaying a planned nuclear unit. "We have to move forward even though we don't know what the rules of the road are going to be," says John Stowell, Duke Energy's vice-president for environmental policy. "It's just maddening."

That's especially true for small businesses, which lack the resources to stay abreast of regulatory changes. Companies with fewer than 20 employees spend an average of $10,585 per worker complying with rules, compared with $7,755 for companies with 500 or more workers, says the Crain study.

Costs that larger companies take in stride can bankrupt smaller rivals. After a spate of unsafe-toy recalls, Congress in 2008 established new testing requirements. Large manufacturers can spread the cost over tens of thousands of units, so their prices are little affected. But Jill Chuckas, 40, owner of home-based Crafty Baby in Stamford, Conn., worries that the new tests may force her to stop selling handmade toys and children's blankets as soon as next month. "I don't know what we're going to do," she says. "We hope and pray every day."

One of Chuckas' best-selling products is a quilted fabric "clutch ball" that retails for $16.99. "Safe for eating, grabbing, throwing at siblings and furniture," the Crafty Baby website promises. The new law requires Chuckas to prove that claim with costly tests that she says would almost triple the price of each ball.

Amid complaints from small companies, the Consumer Product Safety Commission last year decided to delay the new rule until Feb. 10. The Handmade Toy Alliance, representing Chuckas and other small producers, has proposed testing only once every 10,000 units. "We have no idea how that's going to play out," says Chuckas.

Big business doesn't always get its way in the regulatory wars. In December 2007, a group representing industrial power users facing soaring electric bills petitioned federal regulators for an investigation of deregulated electric markets. Steelmaker ArcelorMittal told state regulators in Pennsylvania last year that deregulated electric prices were roughly 50 percent higher than in regulated markets. In neighboring Maryland, soaring electric bills prompted Alcoa's 2005 closure of its 600-worker Eastalco aluminum smelting works.

Industrial users asked for changes, including more say in transmission networks' operations. "Typically, these are folks who would want less regulation," says Joe Nipper, vice-president for government relations at the American Public Power Assn., which joined the petition. Federal regulators responded that competition in deregulated states is working. So some of the nation's largest corporations now are asking Congress for something that business is supposed to abhor: regulation. B

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A Look Ahead

The year ahead holds promise, and some peril, for companies in health care, energy, technology, transportation, finance, and defense. A sector-by-sector look at 2011

Business Prepares For a New Rule Book



Finance

Making the Most of Dodd-Frank

After more than 20 years in Hackensack, N.J., Financial Service Centers of America (FiSCA), a trade association representing check-cashing stores and payday lenders, packed up its headquarters in December and moved to a more strategic location: Washington, D.C.

The group's offices are now just two blocks from the Consumer Financial Protection Bureau, the nascent federal regulator created by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act to oversee a broad array of financial firms, including those such as **Dollar Financial** and **ACE Cash Express** that offer quick cash at annual interest rates as high as 400 percent.

FiSCA's members, largely regulated at the state level until now, handle about $106 billion a year in transactions for more than 30 million customers and are hoping to take even more market share from traditional banks. The new consumer agency, which has the power to write rules that would mandate repayment terms and force disclosures of loan costs, may determine whether they succeed or fail. Ed D'Alessio, general counsel for FiSCA, says the move to Washington was "necessary to meet the increased level of regulation that's coming down the pike."

While the Dodd-Frank law established the broad outlines of a new regulatory landscape, federal agencies are now writing at least 330 new rules governing everything from derivatives trading to the mortgage industry. Decisions being made at the Securities and Exchange Commission, the Federal Reserve, and other agencies will not just ordain how companies must act. They'll also determine which ones are dealt into moneymaking opportunities created by Dodd-Frank—and which are shut out. The actions of regulators such as the consumer bureau will "create key precedents for decades to come," says Douglas J. Elliott, an expert on financial regulation at the Brookings Institution and a former JPMorgan Chase investment banker. "Bankers could be hurt badly or could come away without too much damage, and the economy could be helped or hurt, depending on those choices."

Financial firms such as **Wells Fargo**, one of the nation's largest mortgage lenders, are already attempting to use the new regulatory system to gain a competitive advantage. The bank, which originated more than $100 billion in residential mortgages in the third quarter of 2010, broke with its rivals last month in lobbying for a rule that will require banks to keep a stake in home loans they sell or package into mortgage-backed securities.

While competitors such as **U.S. Bancorp** and **SunTrust Banks** want regulators to exempt a broad array of mortgages from that requirement, Wells Fargo is urging the federal government to



exempt only loans with at least a 30 percent down payment. Smaller banks complain that this would give Wells Fargo a competitive advantage because it's big enough to more easily keep riskier loans on its books.

In some cases, Dodd-Frank is creating new markets for financial services. The law requires that most transactions in the $615 trillion over-the-counter derivatives market now be processed through clearinghouses, allowing regulators and buyers and sellers to see who holds the complex financial instruments and what they cost. Companies such as **Nasdaq Omx Group** and **Goldman Sachs**, which own stakes in clearinghouses, could share in the increased revenue from clearing fees. Analysts at Keefe, Bruyette & Woods estimated last month that revenue could grow by $410 million by 2012, thanks to the new Dodd-Frank requirements.

Making the price of derivatives more transparent is among many rules mandated by Dodd-Frank that are aimed at managing speculation by big financial interests at the expense of smaller users. Companies ranging from **Delta Air Lines** to small heating-oil suppliers have been urging regulators to limit speculation.

In addition to writing the Dodd-Frank rules this year, regulators will launch 122 oversight panels and offices required by the law, according to a BGov analysis. They range from a federal insurance office at the Treasury Dept. to an office overseeing credit ratings at the SEC. As these entities are formed and staffed, they will provide businesses with opportunities to influence the rules controlling their industries.

Regulators face a July deadline for writing many of these rules. They're getting some political pressure to slow down. Republicans, who regained a majority in the House of Representatives this year, have vowed to repeal some Dodd-Frank provisions or cut funding for regulators such as the SEC. Their power to do that will be limited because Democrats still control the White House and the Senate. Also, officials in charge of the regulatory agencies favor the changes in the Dodd-Frank law, in most cases, and will be pushing to move ahead quickly, according to Barney Frank (D-Mass.), one of the authors of the Dodd-Frank law. Says Frank: "I think there will be full implementation. In every case the reg-

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ulators were active participants in writing this law." —*Clea Benson*

The analyst's take *A Bloomberg Government study found there are more than 122 points of entry for financial-services lobbyists hoping to influence rulemaking under Dodd-Frank. Large banks are pitted against smaller lenders with each side seeking a competitive advantage.*



Health Care

After the Midterm Election, a Battle Royal

The economic impact of President Barack Obama's health-care overhaul continues to be debated, with Republicans such as new House Speaker John Boehner calling it a job killer. For lobbyists working on behalf of the health-care industry and employers, though, the law amounts to a full-employment act.

Insurers led by **UnitedHealth Group** want to charge older patients more than the law allows. Drugstores led by **CVS Caremark** want to roll back a prohibition against using tax-free savings accounts to buy over-the-counter medicines. Hospitals, doctors, and drugmakers led by **Pfizer** are trying to dismantle a board created to recommend Medicare spending cuts. And the medical-device industry wants to scrap a new tax levied on their products.

November's midterms elections gave Republicans control of the House and energized opponents of health-care reform, who see opportunities to punch holes in the Patient Protection and Affordable Care Act–if not repeal it altogether. The shift in the balance of power has led to "an open season ... to lobby both Congress and the Administration for some flexibility," says Dan Mendelson, chief executive officer of Avalere Health, a Washington (D.C.) consulting firm.

The government has granted waivers to more than 220 companies and unions so they can offer skimpier health benefits than the law requires. Among those to win reprieves are the United Federation of Teachers and **Darden Restaurants**.

Now, businesses are turning to newly empowered congressional Republicans. While outright repeal of the law is a political impossibility for at least the next two years, Republicans can use votes and hearings to apply pressure and "affect the shape of regulations," says Mendelson.

Businesses are encouraged by signs the Administration is willing to delay some requirements of the law to prevent reductions in insurance coverage before new insurance marketplaces, or "exchanges," open in 2014. The government will consider requests from state insurance commissioners to temporarily adjust new rules requiring that health plans spend at least 80 percent of premium revenue on health services, says Jessica Santillo, a spokeswoman for the Health and Human Services Dept. Insurers like UnitedHealth have threatened to withdraw from some markets if the spending rules aren't eased. "It's not to the advantage of consumers if insurance markets collapse," says Timothy S. Jost, a professor of law at Washington and Lee University in Lexington, Va.

Another battle is brewing over the law's age-rating requirement, which would prohibit insurers from charging older people more than three times what they charge young adults. The provision doesn't take effect until 2014, yet the AARP already is preparing to defend it. Insurers would like the ratio increased to better reflect the risk of covering an older and sicker population. "We did hand-to-hand combat with the insurers all the way through health reform on this issue, so it's no surprise" it would be revived, says John Rother, senior vice-president for public policy at AARP.

Robert Zirkelbach, a spokesman for America's Health Insurance Plans, a Washington (D.C.) trade group, says the industry favors a 5-to-1 ratio. That formula would cut premiums for 18- to 24-year-olds by about 31 percent, according to data compiled by Bloomberg based on an analysis of claims and premiums by the consulting firm Oliver Wyman. Americans 60 and older, meanwhile, would see their premiums rise about 15 percent.

Without a change, young people may decide to forgo coverage and pay the government penalty. Zirkelbach says his group is now "educating folks" in Congress to lay groundwork for a change. The elections may have delivered a receptive audience.
—*Alex Wayne, with David Nather*

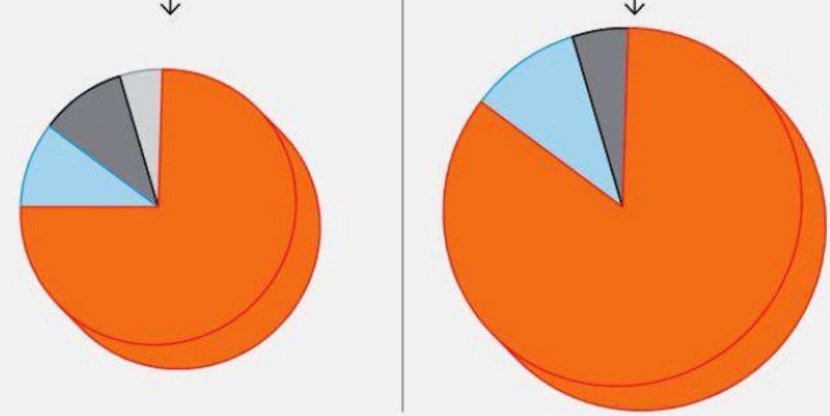
The analyst's take *Bloomberg Government finds the U.S. has already spent $3.8 billion implementing the health-care law, and two of its major goals, cost savings and improved access, are in jeopardy. Industry groups are lining up to kill the law's few cost-saving provisions, including the Independent Payment Advisory Board. In addition, basic economics dictates that few young adults will buy coverage unless the penalty for not having insurance is increased or its cost is lowered.*

Understanding the Application of the Medical Loss Ratio

To hold down medical costs, the new health-care legislation limits the profit and overhead of insurers to no more than 20 percent of their premium revenue. The remaining 80 percent must go to patient care. This well-intended government initiative may have unintended consequences.

Under the new law, insurers must spend at least 80% on health care, with administrative costs and profits not to total more than 20%. Anything over 20% gets rebated to consumers.

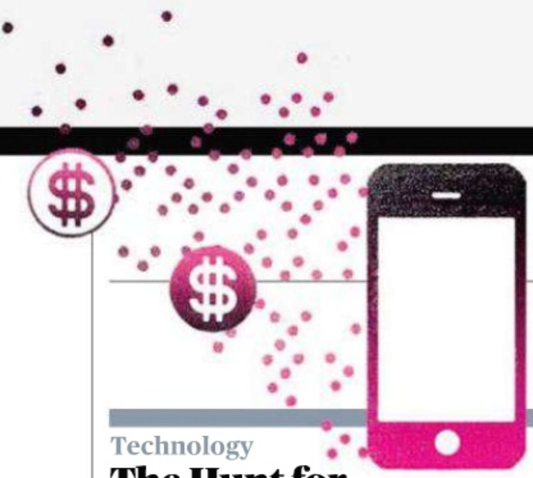
The change creates an incentive for insurers to spend more on medical care—even wastefully—as this expands the size of the pie and increases the amount of permitted profit.



DATA: BLOOMBERG GOVERNMENT ANALYSIS

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Technology

The Hunt for Broadband Spectrum

Decisions made in Washington this year could mean your smartphone will run faster—and eventually produce billions in added revenue for wireless companies.

The Obama Administration has pledged to double the amount of airwaves available for data-hungry devices such as smartphones and tablet computers. Accelerating demand for these gadgets could bring a "spectrum crunch," saddling consumers with lousy service and high prices, says Julius Genachowski, chairman of the Federal Communications Commission. The squeeze could come soon. Wireless data flows may increase 35-fold over the next five years, Genachowski told attendees at the Consumer Electronics Show in Las Vegas on Jan. 7.

One place to look for spectrum, he says: the airwaves controlled by broadcast TV stations, whose owners include **CBS**, **News Corp.**, and **Walt Disney**'s **ABC**. TV stations switched from inefficient analog broadcasting to efficient digital signals two years ago, freeing up a portion of their allocated airwaves. To lure TV stations into giving up spectrum that he believes is no longer vital to their business, Genachowski wants to pay them. Money would come from auctioning excess airwaves to mobile carriers such as **AT&T**, **Verizon Wireless**, **T-Mobile**, and **Sprint Nextel**. The airwaves could fetch $48 billion and add that same amount to carriers' annual sales, according to Coleman Bazelon, an economist with the Brattle Group in Washington.

Proponents of the idea include the Consumer Electronics Assn., with members such as handset makers **Motorola Mobility** and **Samsung**. CEA President Gary Shapiro says broadcasters "are squatting on our broadband future."

TV stations are in no rush to give up spectrum. Gordon H. Smith, president of the National Association of Broadcasters, says stations need time to experiment with digital uses of their airwaves. "There has to be sufficient room in the Digital Age for both broadband and broadcast," Smith says. His members could ask Congress to block the FCC. "Is it really the government's role to pick winners and losers?" Smith asks. —*Todd Shields*

The analyst's take *Bloomberg Government estimates reallocated television spectrum is seven times more valuable at auction to wireless providers than when it's used by TV broadcasters. TV generates about $51 million for each megahertz used. That compares with $365 million that wireless companies paid for each megahertz at auction in 2008.*



Trade

Unleashing Exports Tied Up in Red Tape

Eric Hirschhorn keeps two axle pivots on his desk at the Commerce Dept. He uses them in a test he gives visitors: Which is a military part, for which overseas sale can lead to a prison term? Which is for fire engines and can be sold worldwide? "The differences are almost imperceptible to the naked eye," says Hirschhorn, Under Secretary of Commerce.

President Barack Obama's vow to double U.S. exports turns in part on an effort by Commerce Secretary Gary Locke and Defense Secretary Robert Gates to end such uncertainty by reworking export restrictions. The changes could boost U.S. exports by $57 billion a year, according to a study by the Milken Institute, an economic research group in Santa Monica, Calif.

In the first half of this year, officials such as Hirschhorn will determine which products can be cleared for export. Three-quarters of the items on the first list reviewed—there are 20 more to go—were found not to pose a national security risk.

The initiative has drawn praise from companies most affected by the curbs, among them **Boeing**, **United Parcel Service**, and **Lockheed Martin**. "Change is long overdue but has never been more needed than now," Thomas H. Casey, a spokesman for Lockheed, said in an e-mail.

Under the current system, exporters must seek government approval before exporting items that could have military uses. Exporters complain of overlapping lists maintained by the Commerce and State Depts. The State Dept.'s munitions list captures everyday items such as hoses, wires, or brake pads that may have been designed for a military system and are now widely available in civilian use, says Remy Nathan, vice-president of the Aerospace Industries Assn. in Arlington, Va.

Beyond export controls, business lobbyists are working to get Congress to clear the stalled free-trade agreement with South Korea after Obama negotiated changes that won over dissatisfied U.S. automakers. House Republicans also want to push for approval of deals with Colombia and Panama that have been opposed by labor unions and some Democrats. Says Doug Goudie, director of international trade at the National Association of Manufacturers in Washington: "2011 is the year we absolutely need to deliver results on trade." —*Mark Drajem*

The analyst's take *President Obama argues that his goal of doubling U.S. exports, to $3.14 trillion, by 2015 will create jobs and accelerate economic recovery. Bloomberg Government, using Milken Institute estimates, concludes that gains from export-control reform would provide 4 percent of the boost needed to reach that goal.*



Labor

Beyond the Reach of Republicans?

Business groups may find the expanded ranks of Republican allies in Congress won't be able to stop Democratic appointees from making it easier for unions to recruit members.

The Democratic majority on the National Labor Relations Board could soon rule on cases that would give unions greater access to company

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property for organizing drives. The board may also push for speedier elections after workers petition for a vote, limiting companies' ability to muster a defense. "What people wrongly assume is that, with the Republicans taking over the House, there won't be labor and employment regulation that's adverse to business," says Garry G. Mathiason, a labor lawyer with Littler Mendelson in San Francisco who represents employers. "That couldn't be more wrong. The Obama Administration will greatly influence things through the regulatory process."

The NLRB, whose mission is to remedy unfair labor practices and certify union elections in businesses, is led by Craig Becker, a former lawyer for the Service Employees International Union and the AFL-CIO. After Republicans and business groups opposed Becker's nomination, President Obama named him through a recess appointment that expires at the end of this year. There are four people now on the five-member board: three Democrats and one Republican.

Business groups cite several moves last year as justifying their concerns about what they see as the board's tilt toward labor. In November the board's regional office in Hartford challenged a company for dismissing an employee who criticized her employer on Facebook. In a 3-2 decision in September, the board upheld the rights of unions to set up protest banners outside companies. "The concern in the employer community is that the pendulum is going to swing far to the other side," says Michael Eastman, executive director of labor law policy with the U.S. Chamber of Commerce.

Employers may also see new rules on worker safety and steeper fines for violations. Officials with the Occupational Safety and Health Administration say they're taking stronger steps to reduce injuries and illness in the workplace.

Under changes that took effect in October, penalties for safety violations classified as serious will rise to about $3,000 to $4,000 from about $1,000. A serious violation includes those where a hazard could lead to death or major injury.

Labor leaders, disappointed that Obama and Democrats in Congress failed last year to deliver card-check legislation that would have made it easier for unions to organize, say they are counting on regulatory action instead.

"After eight years of an Administration that deregulated our economy and gave Wall Street ... and other abusers free rein, President Obama is bringing balance back to our economy and holding corporations accountable," said AFL-CIO spokesman Josh Goldstein in an e-mail. —*Stephanie Armour*

The analyst's take *The NLRB's political makeup correlates with changes in union membership, according to data compiled by Bloomberg. Since 1960, union membership declined an average of 2.3 percent a year when Republicans held the board's majority. With Democrats in the NLRB majority, union membership declined less, at 1.5 percent a year.*



Transportation

For Carmakers, a Fresh Shot of CAFE

Automakers are locked in an ecological arms race. Manufacturers such as **General Motors**, maker of the Chevrolet Volt, and **Nissan Motor**, whose Leaf recently went on sale, are pinning their hopes on electric vehicles. Beyond satisfying green customers, the new models are critical to car companies' goal of meeting the government's mandate that their fleets average 35.5 miles per gallon of gasoline by 2016.

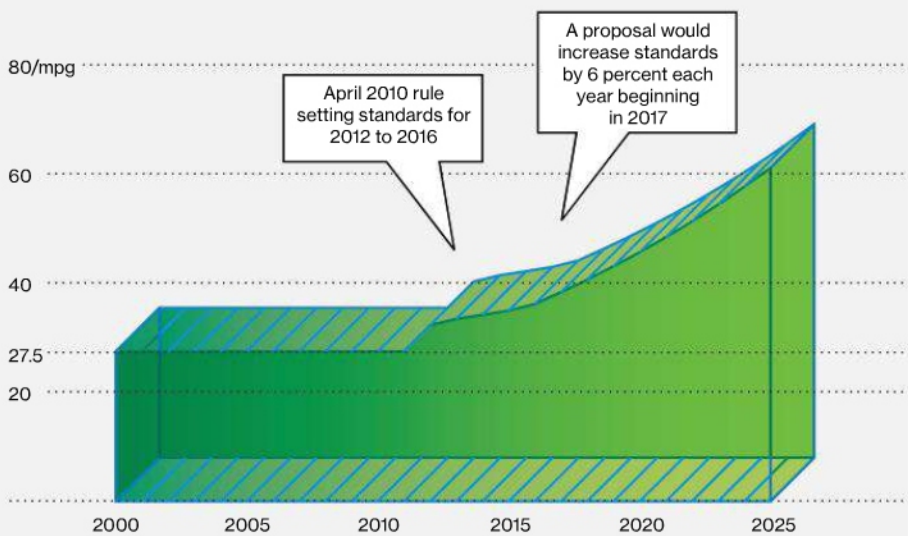
The race is just starting. U.S. regulators, led by the Environmental Protection Agency, will decide by September future mileage standards under the Corporate Average Fuel Economy (CAFE) program. The higher the number, the greater the cost. The EPA is considering 62 mpg by 2025, compared with 27.3 today. "A very aggressive implementation will mean new technology," says Michael Robinet, an analyst with IHS Automotive in Northville, Mich. "It changes the way you design vehicles. It changes your power train. It changes the payback, and it changes the risk."

The CAFE revisions were the most expensive federal regulation of 2010, costing industry $10.8 billion over the next six years, according to the Washington-based Heritage Foundation. The next stage should be even costlier. Hitting a 62 mpg target would mean an average of $5 billion to $10 billion per carmaker over nine years for the largest automakers in the U.S. market, according to Jesse Toprak, an analyst with TrueCar, a Santa Monica (Calif.)-based automotive research website.

Consumers would pay $770 to $3,500 more, depending on the standard used and technologies needed, according to a

Raising the Fuel Efficiency Bar

Regulators are considering increasing fuel efficiency requirements for automakers by 6 percent a year, reaching 62 miles per gallon by 2025. Cars for model year 2012 already will face the first increase in fuel efficiency standards since 1990.



DATA: NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION

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September analysis by the EPA, the National Highway Traffic Safety Administration, and the California Air Resources Board. Two-thirds of U.S. cars would have to be electric or gas-electric hybrids to meet the most aggressive 2025 targets, says Gloria Bergquist, spokeswoman for the Washington-based Alliance of Automobile Manufacturers. Currently, hybrid models like the Toyota Prius make up less than 3 percent of the market. The Alliance has been pushing for a lower target.

For a company such as GM, where SUVs and pickups mean profits, the road to 62 mpg runs uphill. "We have a stated goal of not fighting change but embracing it, and achieving it as best we can," Chief Executive Officer Daniel F. Akerson told reporters on Jan. 7. "The laws of physics are not going to be suspended."

Other transportation regulation battles for 2011 will be over proposed rules requiring more rest for airline pilots and commercial truck drivers. —*Jeff Plungis*

The analyst's take *Automakers must boost average fuel-efficiency standards to 35.5 miles per gallon by 2016. A proposal to reach 62 mpg by 2025 is similar, in percentage terms, to the target of the first standards created in 1975 in response to the oil embargo.*



Energy

Wanted for Questioning: The EPA

Representative Fred Upton (R-Mich.), the new chairman of the House Energy and Commerce Committee, says he plans to summon Environmental Protection Agency Administrator Lisa P. Jackson to Capitol Hill for questioning on her policies so often that he's going to reserve a parking place for her.

Among Jackson's proposals targeted by the new Republican majority in the House are limits on toxic emissions from boilers, a revised national standard for smog, and the first-ever greenhouse-gas-emission curbs, which Republicans along with some Democrats say could raise energy prices and cost jobs.

"The EPA has its foot firmly on the throat of our economic recovery," Upton said in a Dec. 23 statement, referring to the agency's planned carbon regulations.

Keeping the EPA from imposing greenhouse-gas cuts after Congress rejected climate legislation last year is highest on the GOP's to-do list on energy, Upton says.

The greenhouse-gas rules will spur investment in clean energy and create jobs, Jackson said in a Dec. 23 statement. She also pledged to move forward in a "measured and careful way" to reduce the threat of climate change.

Aric Newhouse, senior vice-president of the Washington-based National Association of Manufacturers, says the group was pleased the EPA decided in December to delay its boiler rule, after businesses complained of the economic impact, and opted to push back new smog rules until summer. Even so, Congress should perform a "robust examination of what the proposals will mean for jobs and economic growth, both on large and small companies," he says.

Like Jackson, Interior Secretary Ken Salazar can expect frequent commutes to the Capitol. Representative Doc Hastings, a Washington Republican who heads the House Natural Resources panel, pledged "thoughtful oversight" of the Obama Administration's moves to "lock up public land to energy development" through new drilling rules and its decision to block oil companies from developing swaths of territory offshore. "All of these issues have serious implications on American jobs and our economic competitiveness," Hastings said in a statement.

Energy Secretary Steven Chu may have to defend what Congress has already given him: billions of dollars in stimulus money for clean-energy programs. More than $20 billion of the $33 billion originally appropriated in the 2009 economic-recovery bill hadn't been spent as of Dec. 31, according to the Energy Dept.

Upton wrote Chu on Nov. 23 to ask how many jobs had been generated by the stimulus funds, which is probably a precursor to a Republican push to rescind the money, says Michael Schmidt, a Washington lobbyist at Chicago-based GolinHarris. Says Schmidt: "He's not going to be as frequent a visitor up there as Lisa Jackson, from what we hear, but he'll come under a lot of scrutiny, for sure." —*Jim Snyder*

The analyst's take *According to data compiled by Bloomberg, the EPA under the Obama Administration has conducted 20.5 major regulatory reviews per year, compared with 10.8 a year under George W. Bush. If House Republicans question every EPA move as they've promised, the agency's rulemaking activity could slow.*

The Cost of Controlling Ozone

When a fight breaks out in Washington, facts are the weapon of choice. Armies of researchers are marshaled and studies lobbed back and forth. A smog-fighting proposal from the Environmental Protection Agency that would impose tougher ozone standards is a classic example. The government and a business group have carefully analyzed the economic impact—and their bottom lines vary by nearly $1 trillion.

	EPA	Alliance/MAPI
GDP costs	Not analyzed	$676.8 billion in 2020
Health benefits	$39–$114 billion in 2020	Not analyzed
Jobs effect	Not analyzed	Net loss of 7.3 million jobs by 2020, or 4.3 percent of the projected labor force
Attainment costs	$68 billion–$118 billion in 2020	$1 trillion in 2020

DATA: BLOOMBERG, EPA, MANUFACTURERS ALLIANCE/MAPI, NERA



The IRS

Tax Preparers Brace For a Shakeout

John Hewitt expects the fragmented tax-preparation industry he's worked in for four decades to undergo a wave of consolidation because of new government regulations. IRS rules that take effect this year require tax-return preparers to register with the government. Eventually the preparers must pass a competency exam and take continuing education courses.

While smaller businesses may have trouble complying, existing corporate training programs at the major chains already comply with the new rules or can be easily adapted. Hewitt estimates that within a decade the big three players will have 50 percent of the paid tax-preparation market, up from about

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THE BUSINESS IMPLICATIONS OF GOVERNMENT ACTIONS

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A Look Ahead

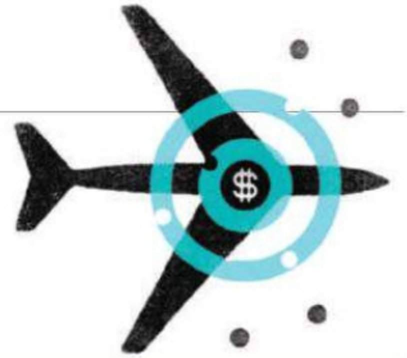
25 percent today, even as they compete with software programs such as **Intuit**'s TurboTax. "It gives us a competitive advantage, and it pushes out the moms and pops," says Hewitt, who started **Jackson Hewitt Tax Service** of Parsippany, N.J., and is now CEO of **Liberty Tax Service**, a closely held company based in Virginia Beach, Va. **H&R Block**, based in Kansas City, Mo., dominates the market, with 20.1 million tax returns filed in 2010.

Kathy Pickering, executive director of the Tax Institute, H&R Block's tax policy arm, says the company's internal training already exceeds IRS requirements. First-year tax professionals get 84 hours of training, and everyone else gets 24 hours of education annually, she says. The IRS will require registered preparers to take 15 hours of continuing education per year.

The tax-prep chains and trade associations continue to lobby the IRS on details related to implementation and enforcement of the new rules. "What's going to be very difficult for the IRS is to identify those who are skirting the system," Pickering says. Both she and Hewitt say they want the IRS to extend the testing to people who prepare tax returns for free through the IRS or nonprofit groups.

The American Institute of Certified Public Accountants won relaxed testing rules for non-CPAs at accounting firms. Now it's trying to ensure that IRS descriptions of the program don't lead taxpayers to view "registered return preparers" and CPAs as equivalent. Edward S. Karl, the group's vice-president for taxation, is less certain than Hewitt about the industry's future under new rules. "If it chases away the fraudulent, that's great for everybody. To the extent that it chases away people who are reasonably competent, that may be more problematic." —*Richard Rubin*

The analyst's take *Total market share for the two largest tax-return preparers, H&R Block and Jackson Hewitt, eroded by about 9 percent during the past four years as do-it-yourself online tax software gained ground. (TurboTax, for example, grew by about 121 percent during the period.) IRS rules may slow the decline by forcing out mom-and-pop preparers.*



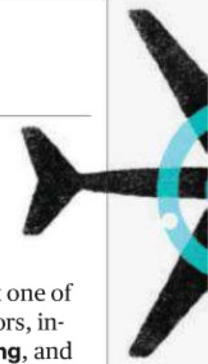
Defense

Tighter Rules for Military Maintenance

Ever since the U.S. Air Force began flying C-17 transport jets nearly 20 years ago, **Pratt & Whitney** has been tasked with repairing the engines, about 200 each year, at its plants. Pratt, a unit of Hartford-based **United Technologies**, developed the C-17 engine from the version it supplies to Boeing's 757 airliner. Pratt has "millions of hours" of experience performing maintenance on both, says William J. Begert, a vice-president for business development



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in the company's military engines unit.

Now an Obama Administration plan to stop outsourcing jobs that can be done by federal employees has Pratt worried that the government may take that work away. Servicing military engines was worth $400 million in 2009 for Pratt. Losing that income would "have a very large financial impact on us" and put several hundred jobs at risk, Begert says.

U.S. law already stipulates that no more than 50 percent of military repair work can be outsourced to private contractors. Early in his Administration, President Barack Obama said government would take back more of the tasks that have been outsourced. In a 2009 memo, Obama called for "clear rules prescribing when outsourcing is and is not appropriate." Those rules are now being drafted by Daniel I. Gordon, administrator for federal procurement policy at the White House Office of Management and Budget.

Obama wants to hasten the move away from the use of private contractors for government work, including military equipment maintenance, a practice that had been increasing for 30 years. From 1985 to 2003, the Defense Dept.'s civilian payroll dropped 43 percent, to 636,000, according to the U.S. Office of Personnel Management. Since then the number has rebounded 15 percent, to 737,000 in 2009, an increase driven by budget cuts at the Pentagon.

Gordon says the White House's goal is not "massive hiring or 'in-sourcing'" but to "correct imbalances that developed over the past few years." The new rules will define functions that only federal employees may perform. Critical tasks still may be outsourced, as long as agencies are able to maintain control, Gordon says.

Contractors want to see how the Administration defines critical functions, according to Robert A. Burton, a partner at the Washington law firm Venable and a former federal procurement policy official. Agencies may argue that even landscaping should be reserved for government workers, he says. "In all seriousness, you could make the argument that trash removal is critical."

The outsourcing rules are just one of the battles that defense contractors, including **Lockheed Martin, Boeing**, and **Northrop Grumman**, are fighting that may affect their profits, says Richard Sylvester, vice-president for the Aerospace Industries Assn. in Arlington, Va. For example, Defense Secretary Robert M. Gates' plan to save $100 billion over five years could affect contractors' profit margins if they are prohibited from passing on to the government some costs that are now allowed, Sylvester says. B

—Gopal Ratnam and Danielle Ivory

The analyst's take *The Pentagon would reverse a long-term trend if it decides to handle more military equipment maintenance, much of which is performed now by private contractors. In 2010, contractors accounted for $14.1 billion, or 45 percent, of the $31.5 billion spent on military repair work, up from $5.3 billion, or 34 percent, in 1991.*

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By the Numbers

The Cost of Measuring Greenhouse Gases

Starting in March, the Obama Administration will make a wide range of companies report on the greenhouse gases they produce. Here's how the cost burden breaks down by industry:

Key Figures

$115 million
Estimated labor and capital cost of regulation to U.S. industry in the first reporting year

10,152
Estimated number of facilities that will report

85%
Portion of human-related greenhouse gas emissions in the U.S. covered by the new rules

Winners

Companies that make so-called coriolis flow meters, used to measure emissions, stand to earn millions. Manufacturers of the devices include General Electric and Siemens.

Losers

Cost of implementing regulation as a percentage of sales:

Cement and mineral production 0.8%

Lime manufacturing 0.4%

Waste management 0.2%

Sectors That Got a Pass[1]

Industries and processes excluded from the reporting requirement:

- Electronics manufacturing
- Ethanol production
- Food processing
- Sulfur hexafluoride from electrical equipment
- Underground coal mines
- Industrial landfills
- Wastewater treatment

It Could Have Cost More

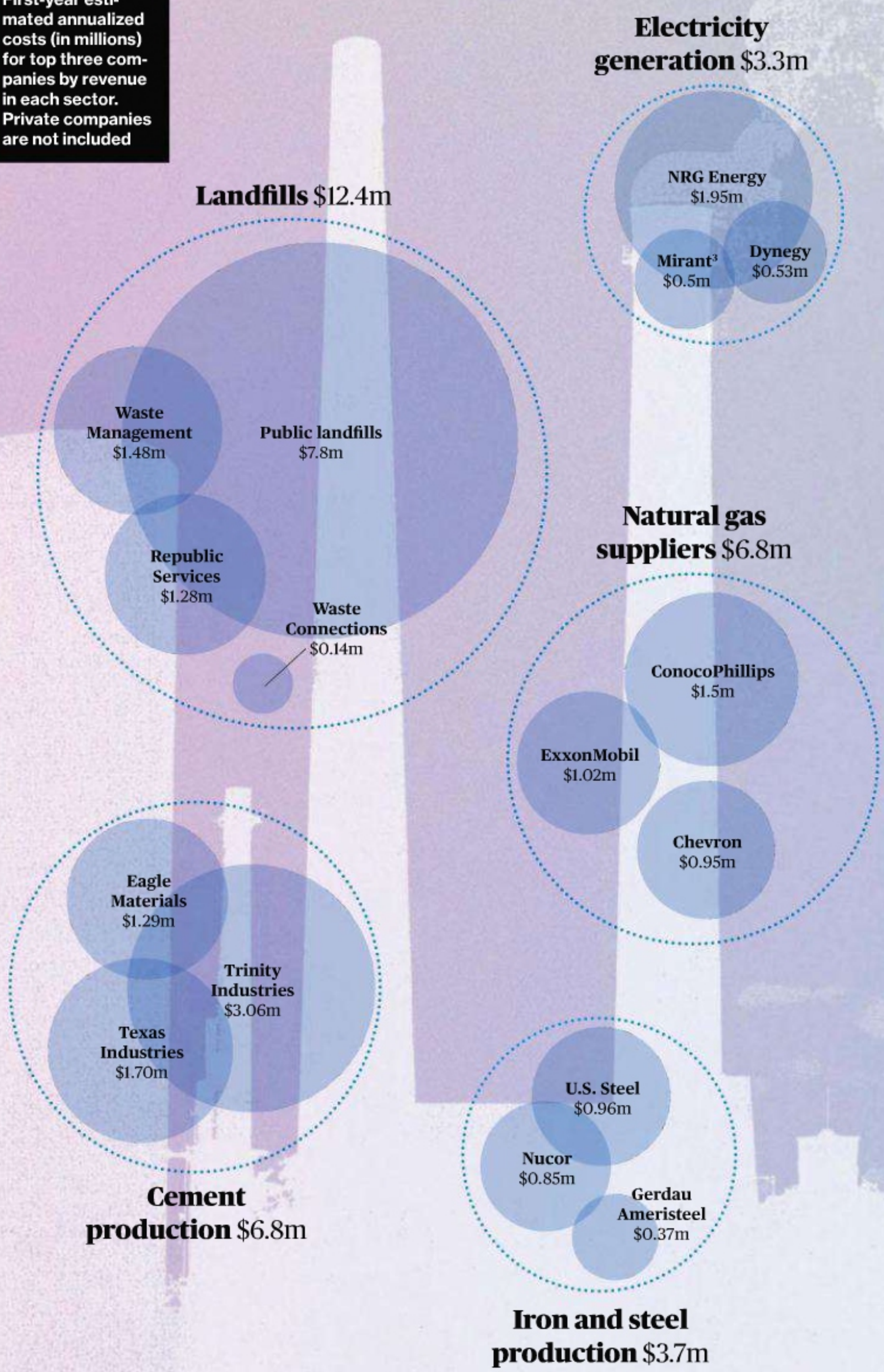
Estimated additional annual cost to U.S. industry if the EPA had required:

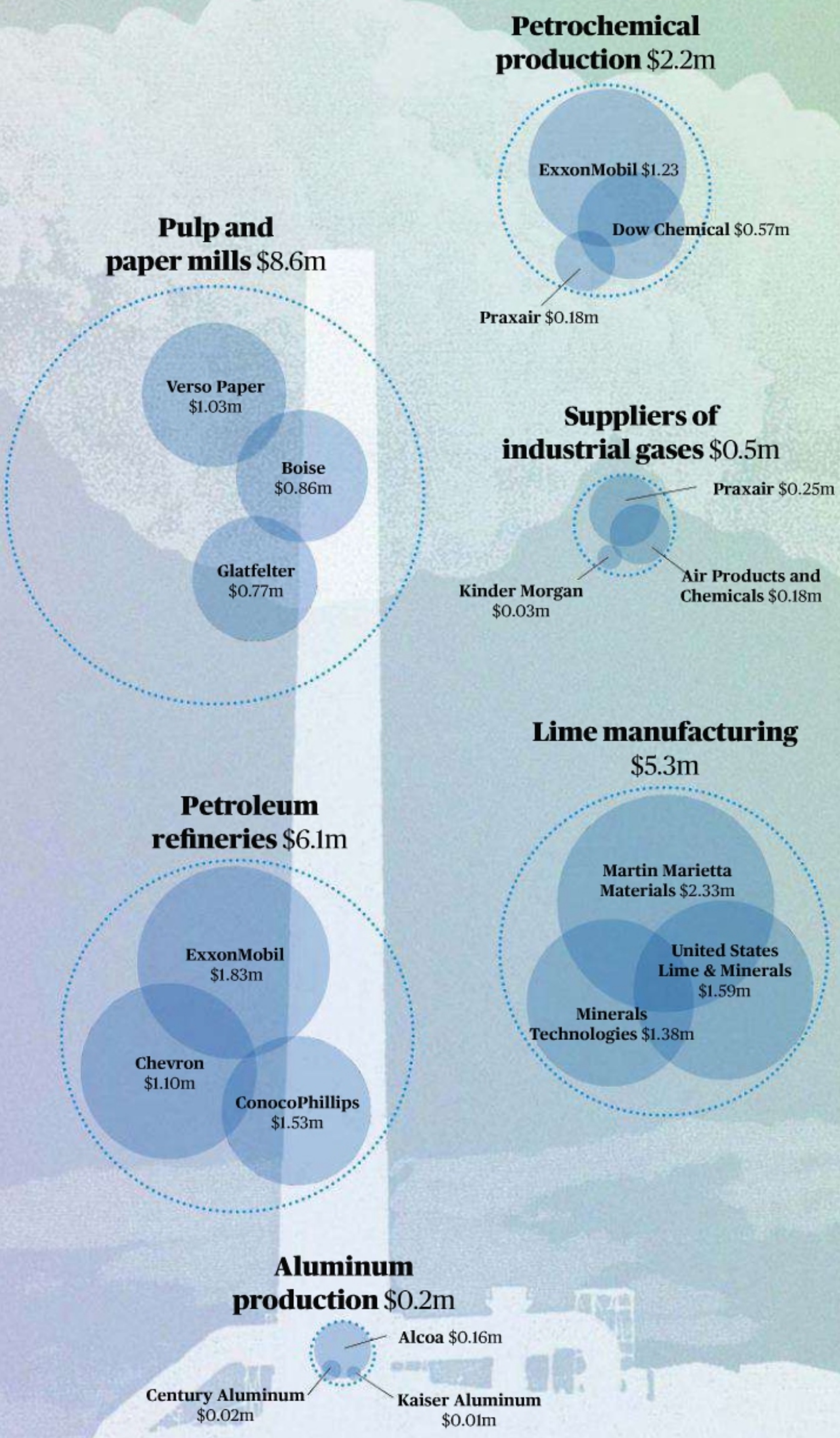
Quarterly reporting $916m

Continuous monitoring[2] $115m

Third-party audits $42m

First-year estimated annualized costs (in millions) for top three companies by revenue in each sector. Private companies are not included





NOTES: 1. SOME INDUSTRIES ARE NOT EXPLICITLY REQUIRED TO REPORT. FACILITIES NEVERTHELESS MUST SUBMIT A REPORT IF EMISSIONS FROM PRODUCTION OR FUEL COMBUSTION UNITS ARE 25,000 METRIC TONS PER YEAR, CO_2 EQUIVALENT, OR MORE. 2. EPA REGULATIONS ALLOW A "HYBRID" MIX OF CONTINUOUS MONITORING AND ESTIMATES. 3. FIGURES ARE FOR MIRANT, NOW GENON ENERGY FOLLOWING A DECEMBER MERGER. 4. VOLUNTARY REPORTING PROGRAM, ESTIMATES FOR 2008, CALIFORNIA OPERATIONS ONLY.
DATA: BLOOMBERG, EPA; COMPANY FIGURES WERE ESTIMATED BY MULTIPLYING THE FIRST-YEAR COST ESTIMATE FOR EACH SECTOR, AS PROVIDED BY THE EPA, BY EACH COMPANY'S SHARE OF TOTAL SECTOR REVENUE, BASED ON DATA COMPILED BY BLOOMBERG

Measuring Harmful Gas Emissions

Carbon dioxide, methane, nitrous oxide, and three groups of fluorinated gases are the major industrial contributors to global warming. The EPA's reporting threshold for these greenhouse gases is 25,000 metric tons of CO_2 equivalents. Some gases are better than CO_2 at trapping heat in the atmosphere. For example, a given mass of methane is 21 times more effective than an equivalent measure of CO_2.

Carbon Dioxide

Carbon dioxide is the primary greenhouse gas emitted by human activities. The largest source of CO_2 is fossil fuel combustion.

Methane

The agriculture sector is responsible for 6 percent of total U.S. greenhouse gas emissions. Methane emissions from livestock digestive processes and manure represent 32 percent of all the "man-related" methane emissions.

Nitrous Oxide

While total nitrous oxide emissions are much lower than CO_2 emissions, nitrous oxide is approximately 300 times more powerful than CO_2 at trapping heat in the atmosphere. Emission sources include soil management and fuel combustion.

Fluorinated Gases

The global warming potential of sulfur hexafluoride is 23,900 times greater than CO_2, making it the most potent fluorinated gas.

Annual Reports

Facilities that emit 25,000 metric tons or more per year of carbon dioxide or equivalent must submit annual reports to the EPA under the new rules. 25,000 metric tons is equivalent to the emissions of:

100	railcars of burnt coal
4,600	passenger vehicles (per year)
6,250	individuals' household emissions (per year)

For Comparison[4]

Annual emission levels of CO_2 equivalents (in metric tons), reported by entities operating in California:

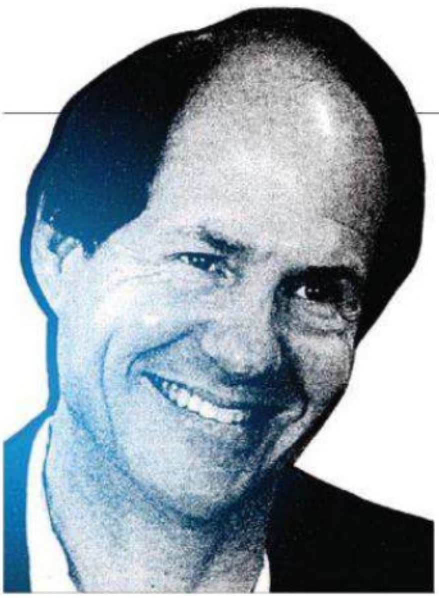
5m	ConocoPhillips Energy company
8,972	Sierra Nevada Brewing Beverage manufacturer
1,853	The Nature Conservancy Environmental nonprofit

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Who's Who

The Power Brokers

Fifteen regulators, lawmakers, and lobbyists shaping the torrent of regulations



REGULATORS

Cass Sunstein

Office of Information and Regulatory Affairs

How do you quiet one of the most prolific and provocative legal scholars in the country? Hand him a portfolio in the Obama Administration that covers nearly every interaction the federal government has with individuals and businesses.

Before he was named the White House's regulation czar, Cass Sunstein, a Harvard law professor and co-author of the best-selling behavioral economics manifesto *Nudge*, opined on everything from promotion of energy conservation to the possibility of permitting lawsuits on behalf of animals. His championship of submitting proposed regulations to rigorous cost-benefit analysis stirred anxiety on the left that he would thwart environmental and other measures. On the right, there were suspicions his behavioralist impulses would foster a manipulative nanny state, leading Fox News commentator Glenn Beck to dub him "the most dangerous man in America." In office, he's become one of the least visible members of the Obama Administration.

The result: The Administration has been missing a potentially powerful voice to counter complaints from business groups that new regulations are overburdening the economy, though Obama stepped into the void on Jan. 18 with an op-ed in *The Wall Street Journal*. Because of concern on the President's communications team about Sunstein's blunt manner and controversial writings, "Cass is being muzzled," says someone who has worked closely with him. "The harm from that is no one knows that the cost-benefit comparison for the first year of the Obama Administration is way better than for the first year of other recent Administrations."

Office of Management and Budget spokesman Kenneth Baer says Sunstein has hardly been silenced, with four speeches posted on the White House website. Sunstein granted a rare interview to Bloomberg Government.

Environmentalist critics such as Rena Steinzor of the Center for Progressive Reform say his Office of Information and Regulatory Affairs has weakened regulation, citing its insistence that the Environmental Protection Agency consider the nebulous "stigma" cost should coal ash be classified as hazardous waste. Still, New York University law professor Michael Livermore says Sunstein's office has been just as assiduous in calculating potential benefits, allowing an economic case in favor of regulation. Efforts to quantify costs of asthma cases, premature deaths, and lost workdays have been used to justify new clean air regulations and a "social cost of carbon" the Administration calculated for action on global warming, Livermore says.

The Administration estimates new regulations issued in its first year produced a net economic benefit of $3.1 billion, vs. net costs of $400 million in Bill Clinton's first year and $300 million in George W. Bush's. "When we're imposing big expenses," Sunstein says, "we want to make sure we're creating even bigger benefits."

Sunstein's imprint has extended beyond mere number crunching. Ideas he championed as a behavioral economics advocate on the importance of disclosing information in readily understandable form are surfacing in the regulatory world. Among them is a proposal to include letter grades in automobile fuel efficiency ratings. "We're interested in providing information in a way that's clear and intelligible," he says. Likewise, his office has promoted disclosure of data over the Internet to ease access. A smartphone application available from apps.gov now allows consumers to get the latest recall information on products simply by photographing the bar code on an item.

Sunstein also is trying to encourage software developers to come up with consumer-friendly ways to make use of the information the government collects. Acting on an idea championed in *Nudge*, he's pressed agencies to release data in a standardized format, with more than 300,000 data sets now on data.gov. "There are large numbers of apps that are coming from what we've disclosed," he says. One that's already online is flyontime.us, developed by the nonprofit Sunlight Foundation, which tracks on-time flight performance. Not only is the information useful to fliers, he says, but it also has a regulatory impact: "It creates a kind of incentive to be on time."

As Republican control of the House shifts efforts to move Obama's agenda forward from passing laws to implementation of the last session's regulatory victories, Sunstein's influence is likely to grow. His visibility is another matter.
—*Mike Dorning*

BLOOMBERG (5); GETTY IMAGES (1)

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Donald M. Berwick

Centers for Medicare and Medicaid Services

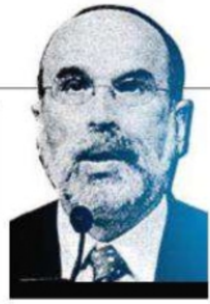
Business Cred: While president of the nonprofit Institute for Healthcare Improvement, he helped hospitals cut down on medical errors and improve treatment of chronic illnesses.
Power Center: Runs Medicare, the federal health program covering more than 46 million elderly and disabled, and helps administer Medicaid, which covers low-income Americans.
Sound Bite: "It is politically correct, and widely believed, to say American health care is the best in the world. It is not."
Quote About: "He is now the poster boy, unfortunately, for overregulation and government mandates and government takeovers and pouring out regulations and so forth that, according to his plan, will 'cure' health care." *—Senator Pat Roberts (R-Kan.)*
Big Wins: Established a $10 billion innovation center authorized by the health-care law to experiment with new ways to pay for care.
Setting Sights On: Implementing new regulations on insurers as part of the health-care overhaul. Winning Senate confirmation before his recess appointment expires at year's end.



Robert S. Khuzami

Securities and Exchange Commission

Business Cred: The former federal prosecutor helped convict the "Blind Sheikh" for the 1993 bombing of the World Trade Center; later became general counsel for the Americas at Deutsche Bank.
Power Center: Director of enforcement at the SEC, which has 13,000 employees nationwide.
Sound Bite: "There will be a heavy price to be paid if firms violate the principles fundamental to our securities laws—full disclosure, honest treatment and fair dealing—and those principles do not change, even if the product is complex or the investor is sophisticated."
Quote About: "He's a hard-nosed prosecutor with real Wall Street experience who understands how the industry works. He's determined to get the biggest bang for the SEC's limited resources." *—Stephen J. Crimmins, former SEC attorney, now partner at K&L Gates*
Big Wins: Last year's $550 million settlement with Goldman Sachs, the agency's largest penalty ever against a Wall Street firm.
Setting Sights On: Insider trading at hedge funds.



Michael R. Bromwich

Bureau of Ocean Energy Management, Regulation, and Enforcement

Business Cred: A former litigation partner at Fried Frank, where he represented defendants in white-collar crime and regulatory cases.
Power Center: Director at BOEMRE, which oversees offshore oil and natural gas drilling.
Sound Bite: "Guess what: Macondo happened, people died, people realized that there were deficiencies in the safety regime."
Quote About: "Mr. Bromwich is the profitability gatekeeper for the industry. He's a tough regulator who is determined to protect the interests of those who would prefer to limit production from the Gulf." *—Ted Harper, Frost Investment Advisors*
Big Wins: Hasn't issued a deepwater drilling permit since the White House lifted its moratorium in October.
Setting Sights On: Ending what Obama called the "cozy relationship" between regulators and oil companies.



Mary D. Nichols

California Air Resources Board

Business Cred: Argued test cases in the 1970s under the federal Clean Air Act and California air quality laws.
Power Center: Only the Environmental Protection Agency has greater regulatory authority.
Sound Bite: "We're proceeding to use our authority to set emissions standards. [The National Highway Traffic Safety Administration] is trying to take that away. They can't."
Quote About: "She's one of the most important people you've never heard of." *—Josh Margolis, CEO of CantorCO2e*
Big Wins: Helped establish first-in-the-nation program to cut greenhouse gases.
Setting Sights On: Pushing automakers and others to use technology to curb emissions.



Jon Leibowitz

Federal Trade Commission

Business Cred: Former chief counsel for Senate antitrust subcommittee. Ex-lobbyist for the Motion Picture Association of America.
Power Center: Chairs the Federal Trade Commission, which has the power to act against anticompetitive business practices.
Sound Bite: "Despite some good actors, self-regulation of privacy ... is not working adequately for American consumers. We deserve far better from the companies we entrust our data to."
Quote About: "He's very good at identifying novel issues that really benefit consumers, and really pushing those issues so they become part of our national agenda." *—Pamela Jones Harbour, former FTC commissioner*
Big Win: Reached settlement with Intel to prohibit the use of threats, retaliation, or exclusive deals to block customers from buying competitors' products.
Setting sights on: "Do Not Track," a mechanism allowing consumers to say they don't want their online behavior and data collected or used in targeted advertising.

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CONGRESS

Sen. Charles Schumer

Democrat, New York

Chuck Schumer is a walking contradiction. He's "the senator from Wall Street," raising more money ($2.5 million) from the securities and investment industry in the past two years than any other member of Congress and driving the $700 billion bailout for



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Who's Who

"too-big-to-fail" banks. The Brooklyn-born politician is also the author of *Positively American*, a book that introduces Joe and Eileen Bailey, an imaginary two-child couple from Long Island that Schumer created as his archetypal middle-class family. "They were the reason I had entered public service," writes Schumer. "Wherever I go, they are always at my side." The New York Senator's working definition of the middle class is an elastic one: Last month he voted to preserve the Bush-era tax cuts on a couple's first $1 million of income.

Now in his fourth decade of congressional service, Schumer loves the limelight and doggedly promotes his ideas in a stream of press statements and Sunday news conferences. It's not for nothing that former Senate Majority Leader Bob Dole once wisecracked that the most dangerous place in Washington was the space between Schumer and a television camera.

Schumer's penchant for publicity is matched by his skills as a guardian of his twin constituencies. He's both a prodigious fund-raiser and a master at identifying issues that resonate with the middle class. One of his causes: increasing the tax-deductibility threshold for college tuition.

Schumer's allegiance to Wall Street is not slavish. He voted for the Dodd-Frank financial overhaul law and is pressing the Securities and Exchange Commission to place curbs on so-called high-frequency trading, the practice of using mathematical algorithms for computerized transactions. "When Wall Street comes in conflict with Main Street, I tend to side with Main Street," he told Bloomberg News in 2009. "When Wall Street comes in conflict with other entities, large entities, overseas or elsewhere, I try to help New York, at least when I think they're right."

As the third-ranking member of the Senate's majority party, Schumer will shape and promote Democratic priorities in the new Congress. He'll resist Republican attempts to chip away at the health-care overhaul as well as efforts to cut funding for the SEC. "If you talk to most people in the markets in both New York and Chicago," he told reporters on Jan. 6, "they want a strong SEC so the bad guys don't dominate the markets." —*Greg Giroux*



Sen. Richard Shelby

Republican, Alabama

Business Cred: Sits on both the Appropriations and Banking Committees; had $17.1 million in campaign cash on Nov. 22, tops in the Senate.
Power Center: He's the top-ranking Republican on the Banking Committee.
Sound Bite: "Fannie Mae and Freddie Mac have already cost taxpayers $150 billion. Absent a strong regulator, future losses could be even greater."
Quote About: "He may be slow. He may be cautious. He may be frustrating. But once he makes the deal, it happens." *—Former Senator Christopher J. Dodd (D-Conn.)*
Big Win: Worked with Dodd on 2008 housing overhaul law to stem foreclosures and prop up Fannie Mae and Freddie Mac. Was lead sponsor of 2003 law that incorporated identity theft protections, including a provision to allow consumers a free credit report annually.
Top Donor: Travelers: $108,250 (2005-10)
Setting Sights On: Dodd-Frank financial regulations, housing, oversight of the Fed, China's currency practices.



Sen. Mark Warner

Democrat, Virginia

Business Cred: Venture capitalist and co-founder of Nextel Communications, now Sprint Nextel
Power Center: Sits on the Banking, Housing, and Urban Affairs Committee and the Commerce, Science, and Transportation Committee.
Sound Bite: "I am drafting legislation that would require federal agencies to identify and eliminate one existing regulation for each new regulation they want to add."
Quote About: "Warner claims the cost of regulation has kept the U.S. business community from participating more fully in our nation's economic recovery. This is basically the same baseless argument that Ronald Reagan used to attack regulation." *—Sidney Shapiro, law professor, Wake Forest University*
Big Win: On Jan. 4, Obama signed into law a Warner proposal requiring federal agencies to produce strategic plans and identify their top regulatory priorities.
Top Donor: Altria: $79,418
Setting Sights On: Regulatory "pay as you go" proposal, telecommunications.

LOBBYISTS

Kirsten Chadwick

Fierce, Isakowitz & Blalock

You won't find her name on a plaque at the entrance of the D.C. lobbying shop. She's not on the firm's letterhead. What Kirsten Chadwick may soon have to show for her skills of persuasion is a U.S.-South Korea free-trade pact. Chadwick, a lobbyist at the boutique Republican firm Fierce, Isakowitz & Blalock, is an expert on trade and the treaties that underpin it. She's seen as a superb vote counter in Washington, tracking the ever-changing yeas and nays on Capitol Hill and knowing when a lawmaker is just being polite—or actually promising a vote. "These abilities get noticed," says Rogan Kersh, a New York University professor who studies lobbying. "Chadwick ... can find herself sought out during pivotal moments ... by Republican congressional leaders, a position every lobbyist dreams of."



Rep. Fred Upton

Republican, Michigan

Business Cred: Grandfather helped found appliance maker Whirlpool, the largest employer in his district.
Power Center: Chairman of the Energy and Commerce Committee.
Sound Bite: "The Obama Administration is on notice. They will not be allowed to regulate what they have been unable to legislate."
Quote about: "Claims of being a Reaganite notwithstanding, there is nothing in his voting record to suggest he would be an aggressive opponent of Obama's plan to impose cap-and-trade through regulation." —Washington Examiner *editorial*
Big Win: Co-sponsored a 2006 law increasing fines for broadcast indecency violations.
Top Donor: EnergySolutions: $38,800
Setting Sights On: National energy policy, telecommunications, nuclear energy, health care.

BLOOMBERG (1); GETTY IMAGES (2)

worldmags

Chadwick represents an array of companies, from Ford to Home Depot to JPMorgan Chase, that are rooting for a U.S.-South Korea pact. Trade deals dictate the rules both countries must adopt on patents, banking, and telecommunications. With almost $68 billion in trade involved, the deal would be the largest for the U.S. since Nafta in 1994, the pact on which Chadwick began earning her reputation. Once again she'll spend a lot of time in the offices of House members trying to secure their votes. "It's not really even lobbying at this point. It's education," she says, referring to Congress' 100 new members.



Chadwick started out as an intern in President George H.W. Bush's congressional liaison office. Her boss, Nicholas E. Calio, was so impressed with the 22-year-old that he brought her to his lobbying shop. The pair returned to the White House under George W. Bush, with Chadwick serving as primary contact with the House Ways and Means Committee, which writes tax laws and approves trade deals.

Chadwick was so involved in passage of the controversial Central American Free Trade Agreement six years ago that newspapers mistakenly reported she was on the House majority whip's staff.

In recent years, Fierce, Isakowitz resisted adding Democrats. The firm's deep relationships with Republicans leaders now back in power in the House, boost the odds of the deal with South Korea becoming law by midsummer.

—*Alison Fitzgerald*



Bill Paxon

Akin Gump Strauss Hauer & Feld

Why He Matters: The former GOP congressman from New York works for the second-biggest U.S. lobbying firm by revenue.
Top Clients: Boeing, Caesars Entertainment, Fluor
Measure of Influence: Close to Speaker John Boehner (R-Ohio), with whom he served in leadership the last time the Republicans controlled the House.
Works With: Former Health and Human Services Secretary Tommy Thompson.
Political Clout: Several House Republicans owe their elections to the former chairman of the National Republican Congressional Committee, who helped bring the party to power in 1995.
Quote About: "Paxon's experience as having been in the leadership of the Republican Congress when they took over the last time makes him a valuable resource." —*Wayne Berman, Republican lobbyist*
Setting Sights On: Health care, financial regulation, farm bill.
Campaign Donations (2010): $38,600
Firm's Lobbying Income (2010): $27.4 million.



Richard E. Wiley

Wiley Rein

Why He Matters: The former Federal Communications Commission chairman runs the largest communications law practice in the U.S.
Top Clients: AT&T, CBS, Gannett.
Measure of Influence: Members of his firm were among those meeting with FCC officials in advance of the commission's net-neutrality vote.
Works With: Jan W. Baran, former counsel to the Republican National Committee and President George H.W. Bush's 1988 campaign. Robert Walker, former staff director and chief counsel of House and Senate ethics committees.
Political Clout: Chaired the FCC's advisory committee on advanced television service.
Quote About: "He's the godfather of digital television." —*Dennis Wharton, spokesman for the National Association of Broadcasters*
Setting Sights On: Wireless spectrum allocation, media ownership, cable-broadcast agreements on retransmission.
Campaign Donations (2010): $14,650
Firm's Lobbying Income (2010): $3.5 million.



Thomas Hale Boggs Jr.

Patton Boggs

Why He Matters: Son of the late Democratic House Majority Leader Hale Boggs
Top Clients: Bristol-Myers Squibb and Legg Mason
Measure of Influence: On behalf of clients such as Mars Inc., he helped obtain a cut in the tax on multimillion-dollar estates.
Works With: Former GOP Senate Majority Leader Trent Lott
Political Clout: Boggs is partner in the biggest U.S. lobbying firm by revenue.
Quote About: "He's smart, trustworthy, and immensely persuasive." —*Democratic lobbyist Jack Quinn*
Setting Sights On: Tax code overhaul, new U.S. Commodity Futures Trading Commission and SEC rules required under the financial reform law.
Campaign Donations (2010): $103,100 (all in this section are personal contributions)
Firm's Lobbying Income (2010): $30 million (all income figures in this section are for Jan.-Sept.).



Ed Mierzwinski

U.S. Public Interest Research Group

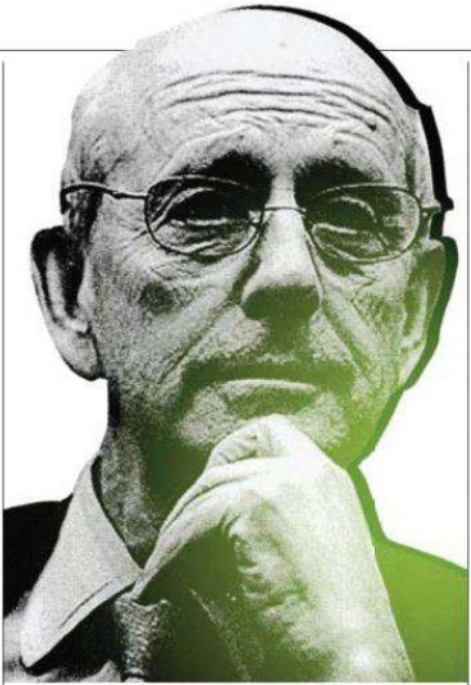
Why He Matters: An expert on consumer issues, he helped lead a coalition of public interest groups pushing for stronger financial regulation.
Measure of Influence: Helped enact the 2008 consumer product safety law.
Works With: U.S. PIRG was part of a pro-banking-regulation coalition with the AFL-CIO, AARP, and the Service Employees International Union, among others.
Political Clout: Founded by Ralph Nader, U.S. PIRG is active in 47 states.
Quote About: "When you think of consumer protection, Ed Mierzwinski is who you think of." —*Lisa Gilbert, deputy director, Public Citizen's Congress Watch*
Setting Sights On: Federal agencies writing the regulations required under the new banking law.
Campaign Donations (2010): $0
Lobbying Expenses (2010): $317,000.

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Point of View

Airline Deregulation Revisited

Supreme Court Justice Stephen Breyer reflects on the benefits of competition–and its hazards



Thirty-five years ago this month, Senator Edward Kennedy (D-Mass.) held hearings on the federal government's regulation of the airlines. His primary focus was on fares. Why were they so high? Officials at the Federal Trade Commission believed that regulation itself was the primary reason. The Civil Aeronautics Board had forbidden price competition. The result was service competition instead: empty seats, steak sandwiches, Aloha bars near the galley, and sky-high prices. A business traveler may be pleased to find an empty seat for his briefcase, an FTC official said at the time, but probably doesn't realize he is paying full fare for the briefcase.

The hearings' objective was to determine if creating more competition–in fares and routes–would improve things. The answer seemed to be yes. In California and Texas, where fares were unregulated, they were much lower. The San Francisco-Los Angeles fare was about half that on the comparable, regulated Boston-Washington route. And an intra-Texas airline boasted that the farmers who used to drive across the state could fly for even less money–and it would carry any chicken coops for free.

Although the board, supported by the airlines, tried to find plausible explanations for high fares, it ultimately failed to do so. For example, were high fares on popular routes needed to support air service to small communities? If so, why should a grandmother flying New York-Los Angeles pay more to help the business traveler flying Utica-Albany pay less? Empirical investigation showed the amount of any such cross-subsidy was tiny and could take the form of a direct government transition payment instead.

When an East Boston constituent asked Kennedy, "Senator, why are you holding hearings about airlines? I've never been able to fly," Kennedy replied: "That's why I'm holding the hearings."

The hearings brought together a Democratic senator and a Republican President in Gerald Ford. They created alliances among consumer groups, pro-competition business groups, economists, and regulatory reformers. They helped make the "regulatory reform" issue politically visible. They showed that government regulation, being administered not by angels but by human beings, was itself imperfect. And they gave content to the notion of reform: In some areas where regulation was necessary–such as health, safety, and the environment–reform would mean "smarter" regulation, sometimes relying more heavily on incentives. In other areas of transportation regulation, reform would mean increased reliance on competition, sometimes to the point where government could abandon the effort to control prices.

Pressure from these broad alliances eventually brought change to the airline industry. President Jimmy Carter took up the theme and appointed as chairman of the Civil Aeronautics Board a Cornell economist, Alfred E. Kahn. Kahn knew regulation; he understood government; and he understood human nature. He began to dismantle fare and route controls and he supported deregulatory legislation, which, with the support of Kennedy and Senators Orrin Hatch (R-Utah) and Strom Thurmond (R-S.C.), became law in 1978. (Kahn, age 93, died last month, and was much mourned by all who knew him.)

What does the industry's history tell us? Was this effort worthwhile? Certainly it shows that every major reform brings about new, sometimes unforeseen, problems. No one foresaw the industry's spectacular growth, with the number of air passengers increasing from 207.5 million in 1974 to 721.1 million last year. As a result, no one foresaw the extent to which new bottlenecks would develop: a flight-choked Northeast corridor, overcrowded airports, delays, and terrorist risks consequently making air travel increasingly difficult. Nor did anyone foresee the extent to which change might unfairly harm workers in the industry. Still, fares have come down. Airline revenue per passenger mile has declined from an inflation-adjusted 33.3¢ in 1974, to 13¢ in the first half of 2010. In 1974 the cheapest round-trip New York-Los Angeles flight (in inflation-adjusted dollars) that regulators would allow: $1,442. Today one can fly that same route for $268. That is why the number of travelers has gone way up.

So we sit in crowded planes, munch potato chips, flare up when the loudspeaker announces yet another flight delay. But how many now will vote to go back to the "good old days" of paying high, regulated prices for better service? Even among business travelers, who wants to pay "full fare for the briefcase?"

As an aide to the late Senator Edward Kennedy, Justice Breyer helped pass the Airline Deregulation Act of 1978.

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Focus On Green Business



The Resurgence of Roman Power

▶ **An Italian startup generates electricity along Rome's fabled aqueduct system**

▶ **"Incentives certainly allowed us to start off, but profitability is now guaranteed even without them"**

The ancient Romans used water pressure to bring the city's monumental baths and fountains to life. Today modern Romans Flavio and Valerio Andreoli are using it to produce clean power. Encouraged by generous renewable energy incentives, their company, **Hydrowatt**, specializes in generating electricity from turbines in aqueducts. "Without producing any kind of waste, we use energy that would otherwise be lost," Flavio Andreoli says as he squeezes his 6-ft., 3-in. frame down the stairs and into a subterranean plant the size of a two-car garage.

Located in the hills of Central Italy, 150 miles northeast of Rome, the room is filled with buzzing turbines that tap into the Ascoli aqueduct to produce 2 million kilowatt-hours a year. Hydrowatt generates nearly 60 million kWh per year—enough for about 30,000 homes—from 40 plants on aqueducts across Central and Northern Italy, making it the largest producer of its kind in the country.

Ancient Rome was known as *Regina Aquarum*, or "The Queen of Waters," reflecting the skill early engineers showed in harnessing water to feed the city's hundreds of fountains and power the empire's mills. They could make water run uphill through the use of gravity and pressure, providing Romans two millennia ago with as much as 250 gallons of water per person daily. The first of the city's 11 ancient aqueducts opened in 312 BC, and the remains of Roman waterworks can be found from England to North Africa.

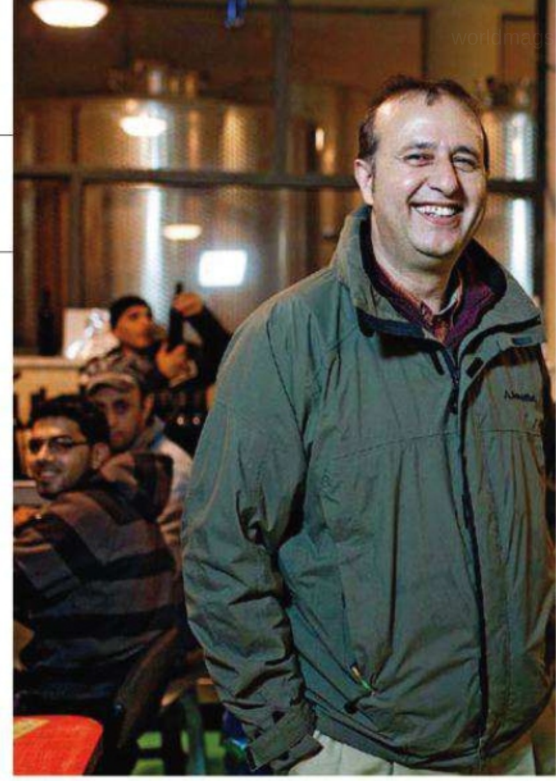
19%
of Italy's electricity comes from hydropower



The brothers tap into modern water pipelines that typically follow the same routes as the old aqueducts. Much like ancient engineers who studied the land and looked for sources at higher elevations to provide the pressure needed to reach Rome, Hydrowatt's engineers seek out places where pipelines have valves designed to release excess pressure as the water flows rapidly down the mountainsides. Once they identify

FROM TOP: PHOTOGRAPH BY ALESSANDRO IMBRIACO FOR BLOOMBERG BUSINESSWEEK; HULTON ARCHIVE/GETTY IMAGES

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such a site, the brothers offer local authorities that control the aqueducts a deal to replace the valves with Hydrowatt's turbines. "We saw there was this excess pressure from water that was lost and could even pose a problem, so we replaced the valves with turbines that could make energy," Andreoli says. "Around this idea we built a company."

A Europe-wide push to get 20 percent of energy from renewable sources by 2020 has led governments to finance projects through incentives and so-called feed-in tariffs, which require utilities to pay above-market rates for green power. Italian utilities pay 22 euro cents (28¢) per kWh of hydro energy, about triple the rate in France and Spain and nearly double Germany's, according to researcher Europe's Energy Portal. Given environmental concerns, traditional hydro projects are tough to sell in Italy, says Tatjana Eifrig, an energy analyst at Banca Finnat Euramerica in Rome. Smaller plants, though, "are extremely interesting, and we see a lot of room for growth in the next two years," she says. "They're helped by incentives, which offer needed startup support to a kind of business that is highly productive once under way."

Andreoli says Hydrowatt is "small but profitable," with revenue of about €11 million ($14 million) last year. "Incentives certainly allowed us to start off, but profitability is now guaranteed even without them," says Andreoli, 41, an engineer and native Roman whose grandfather was deputy mayor of the city in the 1950s. The brothers recently bought four small hydroelectric plants in New England, and they aim to double production globally in the next 36 months by adding more plants and diversifying into biomass and other renewables.

Installing Hydrowatt's turbines costs €1,700 to €2,700 per kilowatt of capacity, while onshore wind plants in Italy cost €1,500 to €3,000 per kW and solar runs €4,500 to €6,000 per kW. More important, hydro plants need neither sunshine nor a stiff breeze to produce power, so they operate all the time. That means each kilowatt of capacity translates into 8,000 kWh of power annually, Andreoli says, at least four times the average output of solar or wind plants. "Small hydro is a good way to go beyond wind and solar and make use of Italy's water resources," says Edoardo Liuni, an analyst at market research firm IlNuovoMercato.it in Rome.

Italy, where 19 percent of energy comes from water power, leads the European Union in small hydro plants (those with a capacity of less than 10 megawatts), according to the European Small Hydropower Assn. "Small hydro is developing very rapidly all over the world and is an important part of renewable energy," says Fatih Birol, chief economist of the International Energy Agency.
—Alessandra Migliaccio and Flavia Rotondi

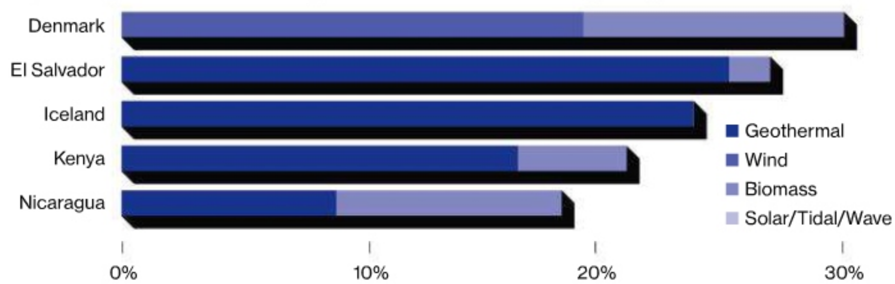
The bottom line *An Italian startup is tapping into aqueducts to generate electricity. It's now planning to expand in the U.S.*

Rankings

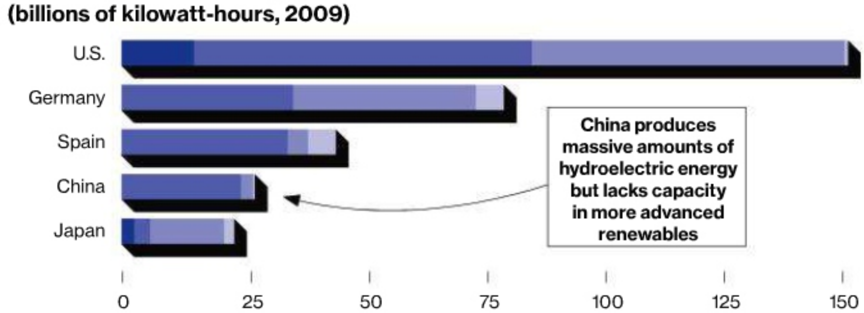
The Renewables Race

Which countries are getting the most electricity from renewable sources instead of fossil fuels? Measured by share, Denmark is No. 1. Viewed in terms of total output, the U.S. and Germany lead the pack. The lineup would change dramatically if hydropower–a mature technology that many critics say is harmful to the environment–were added to the mix: China would take the top spot, followed by the U.S. and Canada.
—Joel Stonington

Top five by share of electricity from renewable sources (2008)



Top five by total electricity generated from renewable sources (billions of kilowatt-hours, 2009)



DATA: U.S. ENERGY INFORMATION ADMINISTRATION

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Abufarha aims to double sales to $10 million in the next three years



1,500

Palestinian farmers sell their produce to Canaan Fair Trade

Agriculture

From the West Bank, Fair-Trade Olives

▶ An entrepreneur prospers with exports of organic olive oil

▶ "I make a much better living while helping out my people"

Nasser Abufarha was sipping coffee at a Madison (Wis.) café called Michelangelo's a few years back when it dawned on him how he might help struggling olive growers in his native Palestine. If the crowd could derive virtuous pleasure from mugs of "fair trade" organic coffee, they might be convinced of the superiority of organic oil pressed from West Bank olives.

Abufarha, a graduate student in anthropology at the University of Wisconsin in Madison, wrapped up his dissertation on suicide bombers and headed home to the West Bank. The olive farming industry there was in a shambles. Yields were low due to poor soil treatment, and farmers were barely breaking even—leading many to abandon their fields and migrate to Palestinian cities, where unemployment hovered around 40 percent.

Tapping into savings from running a Middle Eastern restaurant in Madison, Abufarha in 2004 invested some $100,000 to start a company he called **Canaan Fair Trade**. The son of a watermelon farmer, he offered growers nearly twice the going rate during the olive harvest that year and soon started shipping oil to the U.S. and Europe. "It clicked to me—if we can take [the fair trade] concept to Palestine, we can bring wider market access to Palestinian farmers," Abufarha says in lightly accented English while piloting his mud-splattered Land Rover along the potholed road to his olive press in the village of Burqin.

Canaan supplies organic olive oil to retailers in more than half a dozen countries, including **Whole Foods Market** in the U.S. and **J Sainsbury** in Britain. The company also provides the raw material for an olive oil line of Dr. Bronner's Magic Soaps and has added sun-dried tomatoes and other products that follow the fair trade movement's principles of sustainability and improved incomes for marginalized farmers.

The company works with more than 1,500 farmers in 43 villages. Canaan accounts for more than half of all West Bank olive oil exports, and sales are expected to be as high as $5 million next year with profits exceeding $600,000, says Abufarha. Its products come in folksy packaging, and on a winter day about two dozen employees deliberately apply off-kilter labels to bottles to make the olive oil seem more artisanal.

Abufarha, 46, successfully turned the Palestinian olive oil industry's system for production and payments on its head. Before he arrived, exports were rare and most olive pickers brought their produce to local presses during the harvest, receiving a small amount of cash and a portion of the oil to sell on their own. In 2008, Canaan opened a $500,000 pressing facility with equipment imported from Sweden. The company started offering growers guaranteed prices, allowing them to make investments in their fields and increase production.

In 2003 Mahmoud Samara was earning about $2.80 per kilo of olives and worried that he would have to abandon the 14 acres his great-grandfather once tilled. Then Canaan started paying $4.45 per kilo, giving him extra cash needed to improve his trees and buy more land. "I used to have to bargain with local pressers and make pocket change each time, which made my business very unstable and meant I had to store the olive oil at home," Samara says in an unheated conference room at Canaan's headquarters, a stone building surrounded by olive groves. Samara was already using sheep manure to fertilize his land, so he followed many of the organic techniques Abufarha required, he says. He now makes about $22,000 yearly, up from $8,000 before he started working with Canaan.

Abufarha hopes to double sales, to $10 million, in the next three years and build more olive presses to accommodate a growing list of farmers. He sees his initiative as a model for other Palestinian businesses that might similarly build bridges between Palestinian villagers and liberal and affluent communities in Europe and the U.S., where he still spends several months a year. "I could have been an academic back in the U.S., but with Canaan I make a much better living while helping out my people," he says as a thunderstorm outside the door lashes olive trees believed to date back to the Roman empire. "We have these olives that have been feeding us for over 1,500 years," he says. "Now they're finally being sold in the West."

—*David Wainer and Jonathan Ferziger*

The bottom line *A Palestinian entrepreneur boosted the price paid for organic produce and has become the West Bank's biggest exporter of olive oil.*

Transportation

Battery-Powered Trucks: Toys No More

▶ Frito-Lay, FedEx, Coke, and others are buying electric delivery vehicles

▶ "It's pretty cool for [drivers to say] they didn't use any gas today"

Even as auto manufacturers seek to convince car buyers of the virtues of electric vehicles, one key group needs little persuasion: delivery fleet managers. While commuters and vacationers may fret about so-called range anxiety—the fear of not making it to a charging station before the car's battery needs topping up—drivers of commercial delivery vehicles tend to follow the same route each day, so they have a pretty good idea how much power they'll need. And since trucks typically return to the garage every night, there's little worry about finding a charger. Electrics "are quiet, don't pollute, and vibrate less than diesels," says Mike O'Connell,

PHOTOGRAPHS BY URIEL SINAI FOR BLOOMBERG BUSINESSWEEK

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6% of Frito-Lay's New York-area fleet will be electric by May



director of fleet capability for **Frito-Lay North America**. "Our sales reps are fighting over who gets the next one."

Frito-Lay has bought 176 electric delivery trucks for use across the country, or about 1 percent of its total fleet. As that number grows, O'Connell says, the vehicles will be instrumental in reaching a company goal to halve fuel use by 2020. The trucks, all of them a model called the Newton from **Smith Electric Vehicles** of Kansas City, Mo., have cut fuel expenses and boosted worker productivity, says Bob Simpson, Frito-Lay's fleet manager for the New York region. By May, 6 percent of Simpson's fleet of 250 trucks will be electrics, and if he had his way he would replace all of his diesels with them. They offer "real savings [on fuel], and we expect even more when you factor in very low maintenance and repairs," Simpson says as he threads his way through greasy diesels to show off his Newtons on a Brooklyn lot.

Less than 1 percent of the 135,000 medium-duty trucks that U.S. companies will buy this year will be electric, according to Americas Commercial Transportation Research. But battery prices, which represent about a third of the cost of an electric truck, will likely fall to a quarter of today's level by 2020, which will "drive down costs and create demand," says Glen Walker, an analyst at Bloomberg New Energy Finance. Until then, incentives will likely help sales, he says. The federal government offers a tax credit of up to $7,500 for each electric vehicle, and California and other states offer additional rebates of as much as $5,000.

Ford Motor and **Azure Dynamics**, a Canadian company, in December introduced the electric Transit Connect van. Ford aims to manufacture more than 750 of them this year, vs. 30,000 gasoline-powered models of the same truck. With a range of about 80 miles, the vans cost $57,400, or nearly triple what the gasoline version costs. **Navistar** has built 78 of its $150,000 eStar electric trucks. While the eStars are roughly double the price of similar diesels, Navistar aims to sell some 700 electrics by mid-2012. **FedEx** has bought 19 eStars for use in cities worldwide, though the company says it needs to study their performance before committing to a large order.

Smith hopes to sell about 1,000 Newtons this year, five times what it did in 2010. The $100,000 trucks, with a range of up to 100 miles, are built on a chassis purchased from a Czech manufacturer, and their electric components come from American subcontractors. **Coca-Cola Bottling**, **AT&T**, and utility **PG&E** have all replaced diesels with Newtons, and in December the U.S. Marine Corps ordered two for its base in Camp Pendleton, Calif. While the trucks cost 50 percent more than diesel-powered rivals, Smith Chief Executive Officer Bryan Hansel says buyers will make up for that premium with lower fuel costs and a better image. "Our customers see it as a marketing advantage," he says.

Office supply retailer **Staples** says the benefits are clear. The company has 41 Newtons–about 3 percent of its total delivery fleet–in California, Missouri, and Ohio. Staples is considering an order for more this fall as leases expire on 140 diesels. The company says the Newtons have helped it cut fuel use by 4 percent in the past three months. Passersby often stop drivers to ask about the trucks, says Staples fleet manager Mike Payette. "It's pretty cool for [drivers] to be able to say they didn't use any gas today," he says.

Some buyers, though, say there's still some reason for range anxiety. During a December storm that dropped 20 inches of snow on New York, one Frito-Lay driver got stuck midway through his route and almost drained the Newton's battery rocking the vehicle back and forth to gain traction. He returned to the garage and had to complete his rounds with a diesel, says fleet manager Simpson. Nonetheless, the driver wouldn't hear of switching back permanently. "He said, 'No way,'" Simpson says. "I'd take a beating if I tried to take one of these away from my drivers." —*Christopher Martin*

The bottom line *Companies are starting to use more electric trucks, which they say are ideally suited for urban deliveries.*

Quoted

"If weight and power of cars and SUVs hadn't increased since 1980, technological progress could have boosted fuel economy nearly 50 percent."
—Christopher Knittel, economist, University of California at Davis



Finance

A New Way to Pay Could Give Fuel Cells a Boost

▶ **Bloom Energy plans to sell power by the watt, with no up-front cost**

▶ **"In three to five years we will have a product that requires no subsidy"**

With its compact fuel cells that can generate electricity with low carbon emissions, Bloom Energy is one of the most hyped companies among Silicon Valley's growing roster of green startups. Bloom unveiled its generator on *60 Minutes* last February and boasts A-list investors (John Doerr of Kleiner Perkins Caufield & Byers), board members (Colin Powell), and customers (Google, Coca-Cola).

Yet it has long been unclear whether Bloom could generate power at competitive prices on a large scale. On Jan. 20, Bloom announced a new payment option that it says moves it closer to that goal. A program called Bloom Electrons offers 10-year contracts for metered electricity at 5 percent to 20 percent below the grid rate in California. Before Bloom's new payment method, customers had to pay $700,000-plus for a unit that provides 100 kilowatts of electricity (about what 100 U.S. homes might use).

Paying off that investment typically takes at least three years, says KR Sridhar, Bloom's chief executive officer and creator of its fuel-cell technology. Now,

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That's why we're building them today, with customers all over the world.

It's why we're designing our technology to last longer and use fewer resources. It's why we're helping our customers reduce their CO_2 emissions. And it's why we're pioneering new answers with one of the world's largest environmental portfolios.

As a result, we were just named the best in our business sector by the Dow Jones Sustainability Index. And recognized as the top company overall by the Carbon Disclosure Project, the world's largest independent database of corporate climate change information.

Yet we'd never claim to have all the answers. That's why we're working with 190 countries. Thousands of cities. Tens of thousands of companies. In energy, industry and healthcare.

We're working with the world today to create answers that last for the world of tomorrow.

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Time Warner's fight against free page 80 ▶

"we give them instantaneous payback," Sridhar says, "without them having to put any capital up front." Wal-Mart Stores, Coca-Cola, and Caltech, among others, have signed up for the program. "The economics were an obvious win," says Dean Currie, vice-president for business and finance at Caltech. Bloom's plants already supply half the power needs at two Walmart stores in California, and the retailer plans to add them elsewhere under the new payment plan.

For now, Bloom's technology is available only in California, where state subsidies of up to $2.50 per watt for fuel-cell installations help the company undercut grid prices. Bloom Electrons operates as an independent company, buying fuel cells from Bloom and selling electricity to customers. The new company, with more than $100 million in funding from Credit Suisse Group and Silicon Valley Bank, receives federal grants for up to 30 percent of what it spends on the fuel cells.

Research from Bloomberg New Energy Finance estimates Bloom can produce power at 14¢ per kilowatt-hour over 10 years vs. the average U.S. commercial rate of about 10¢ per kWh. However, with long-term natural gas contracts and state and federal incentives, Bloom can get its price below 7¢. Sridhar promises even lower rates soon. "In three to five years we will have a product that requires no subsidy," he says.

The heart of Bloom's technology is a fuel cell a bit bigger than a playing card that generates enough power to run a light bulb. These are stacked and bundled into modules, then arranged in a box about the size of a shipping container that can produce 100 kW. Each cell consists of a ceramic electrolyte coated on both sides by proprietary inks. Unlike most hydrogen fuel cells, they require no precious metals; Bloom uses zirconium oxide powder, which is readily found in beach sand. The cells are fueled by natural gas or biogas captured from landfills. The gas passes over one side of the cell while air heated to more than 800 degrees Celsius passes over the other. This triggers a chemical reaction that releases electricity, steam, and carbon dioxide. The air is initially heated by burning gas, but after the first few hours the cell recycles heat.

With their compact size and clean, quiet operation, Bloom's fuel cells can be installed almost anywhere, eliminating the need for transmission across a grid, where roughly 10 percent of power is lost. And the conversion from fuel to electricity happens in a single step. A typical power plant, by contrast, burns fuel to produce heat, which spins a turbine that creates a charge in copper coils–losing energy at each conversion. Bloom says its cells using natural gas emit 30 percent to 60 percent less carbon than a gas-fired power plant does.

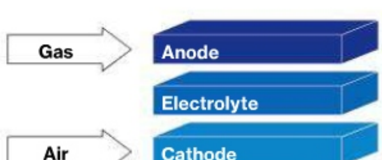
The challenge for Bloom is scaling up production to meet growing demand. "The manufacturing of a fuel cell is a really complicated process," says Bloomberg New Energy Finance analyst Shu Sun. "It's not a hard science. It's more trial and error." Bloom currently makes one 100 kW box per day at its pilot plant in Sunnyvale, Calif. Sridhar acknowledges that the output is tiny but says it's growing fast. "Two years ago, we used to build one box a month," he says. "We are honing this here in the U.S. with the hope we will be able to deploy this model across the world." *—Ira Boudway*

The bottom line *The Valley's Bloom Energy believes a new payment model, with no initial investment from customers, will boost the market for fuel cells.*

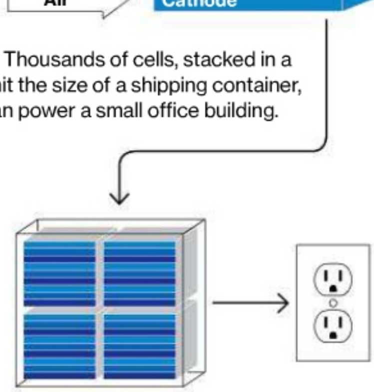
How it works

Bloom Energy's fuel cells run at more than 800 degrees Celsius. Each cell is a layer of ceramic (an electrolyte) coated with special inks on each side.

❶ Natural gas and air react in the cell, creating electricity.



❷ Thousands of cells, stacked in a unit the size of a shipping container, can power a small office building.



DATA: BLOOM ENERGY

Speed Dial Denise Bode

The top wind energy lobbyist in Washington talks about support for renewables in Congress and competing against oil, coal, and China

In December Congress extended tax grants for renewables. What's your top goal this year?
We need a federal renewable electricity standard that requires utilities to get a greater share of their supplies from clean energy. We're after renewable energy targets that would diversify sources of power.

How will the Republican takeover of the House change your tactics?
It's an opportunity to reach out to new members of Congress and educate them about the benefits of wind. We have to show each member how wind affects their state. There are wind industry jobs in 46 states.

Why should the government favor wind over other technologies?
We're competing with a fossil industry that's been getting incentives for over 100 years. We want a level playing field. The fossil industry gets over five times the tax incentives that renewables do. We want policies that ensure that the costs of waste, use of water, carbon emissions, mercury, and all that get considered.

How did China topple the U.S. as the world's largest wind power market last year?
I'm disappointed that they overtook us. It's because they have a policy to promote wind. We're the only major country that doesn't have a cohesive energy policy [to boost its domestic industry]. Because of the size of the equipment, wind turbine manufacturers tend to build where they see demand. We're not for protectionism. We just want to make sure the market is truly free and fair. Ⓑ *—Christopher Martin*

DANIEL ACKER/BLOOMBERG

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AKUO ENERGY

TURKEY

AKUO ENERGY

"Turkey, with its booming economy, rising industry and young population, stands out among the rest. Its potential for renewable energy resources offers promising energy support for sustainable and environmentally-conscious development. Akuo Energy, through its subsidiary Perfect Wind Energy, will be there with several renewable energy plants to give concrete expression to development and investment efforts in Turkey."

akuo ENERGY

Eric Jean Francois SCOTTO,
President of Akuo Energy Group and Perfect Wind Energy, Turkey

INVEST IN TURKEY

- A population of 73 million, half of which is under the age of 28.8
- Approximately 450,000 students graduated from around 150 universities and other higher education institutions in 2009
- Over 25 million young, well-educated and motivated labor force
- Highly competitive investment conditions
- A country that offers 100% and more tax deductions on R&D expenditures
- Access to Europe, Caucasus, Central Asia, the Middle East and North Africa
- 16th largest economy of the world and the 6th largest economy as compared to the EU countries in 2009 (IMF-WEO)
- 15th most attractive FDI destination for 2008-2010 (UNCTAD World Investment Prospects Survey)
- Fastest growing economy in Europe in 2010

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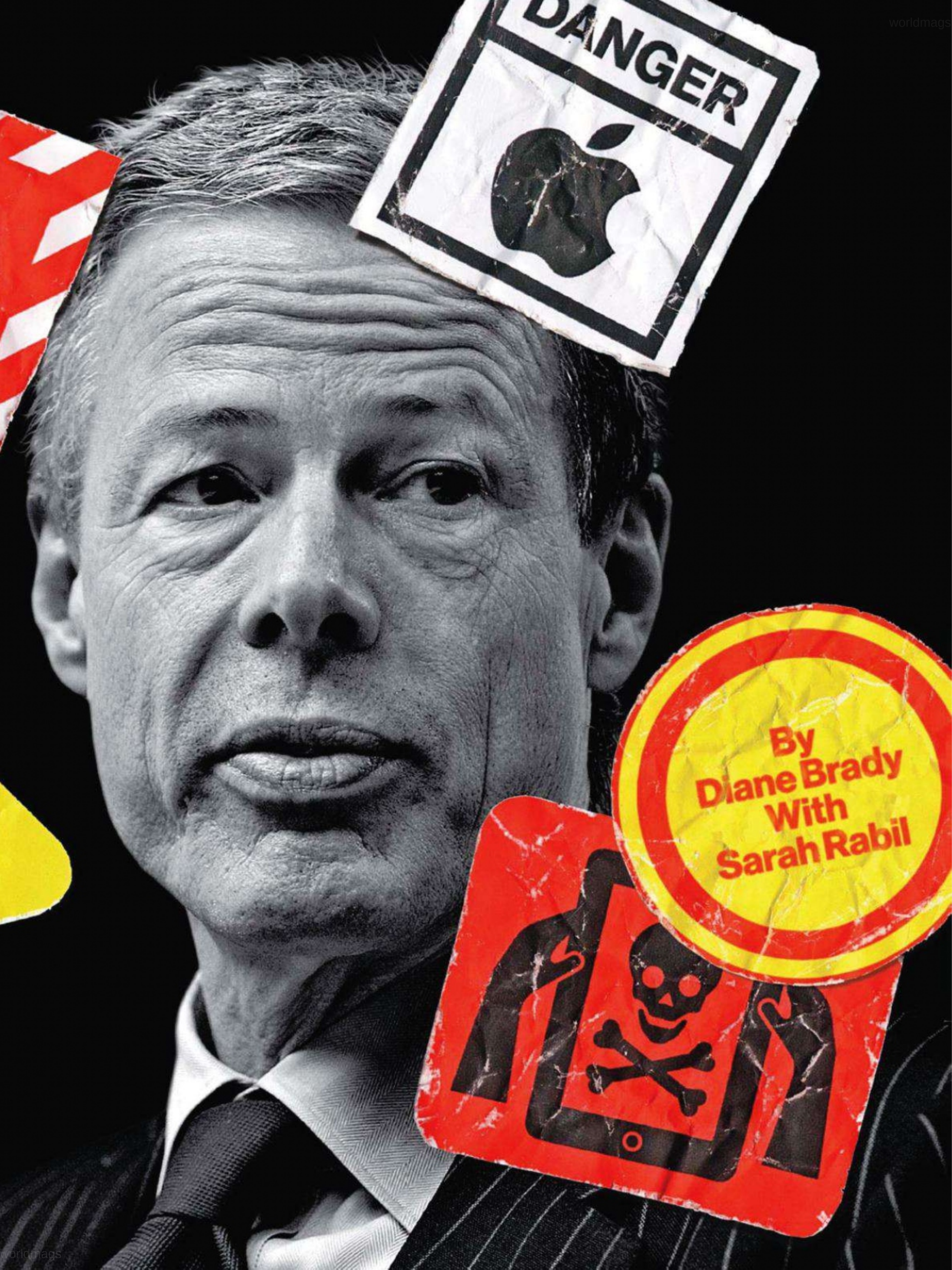
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Time Warner's CEO is standing up for paid content in a world of cheap online video. Can he hold the line against iTunes, Netflix, Amazon, and Hulu?

Jeff Bewkes and the Apple Trap



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In a hangarlike Las Vegas exhibition hall on Jan. 6, Jeffrey L. Bewkes is surrounded by flashing screens, by women in campy space-age outfits, and by aisle after aisle of gadgetry: the great American come-on known as the Consumer Electronics Show. It's been seven years since Bewkes, the chief executive officer of Time Warner, last attended CES, and he looks a little out of place. A few minutes earlier, Verizon Communications CEO Ivan G. Seidenberg brought him onstage as a surprise guest during Seidenberg's keynote, but the tech fanboys in the crowd weren't interested in hearing about Time Warner's vast catalog of movies and TV shows moving onto the Web. They showed more emotion for the demonstration of Google's new "Honeycomb" tablet operating system than they did for Bewkes' video featuring Time Warner stars watching their own TV spots on an array of devices.

Now, moving through a sea of geeks after his presentation, Bewkes resembles a Time Warner character himself–one of those well-dressed, humorless robot agents from *The Matrix,* surrounded by younger, hipper renegades. He strides through the hall, barely glancing at a wall of 3D video screens, and says why he isn't worried about wowing the techies. "I'm here to explain things to the attendees," he says, "because the attendees tend to not understand the media business." At a trade show that celebrates the wonders of low-cost digital distribution, he's an emissary from the land of paid content. His message is simple and sharp: The devices may be cool, but anything that costs money to produce must be paid for, and any service or channel that doesn't carry its weight is destined to die.

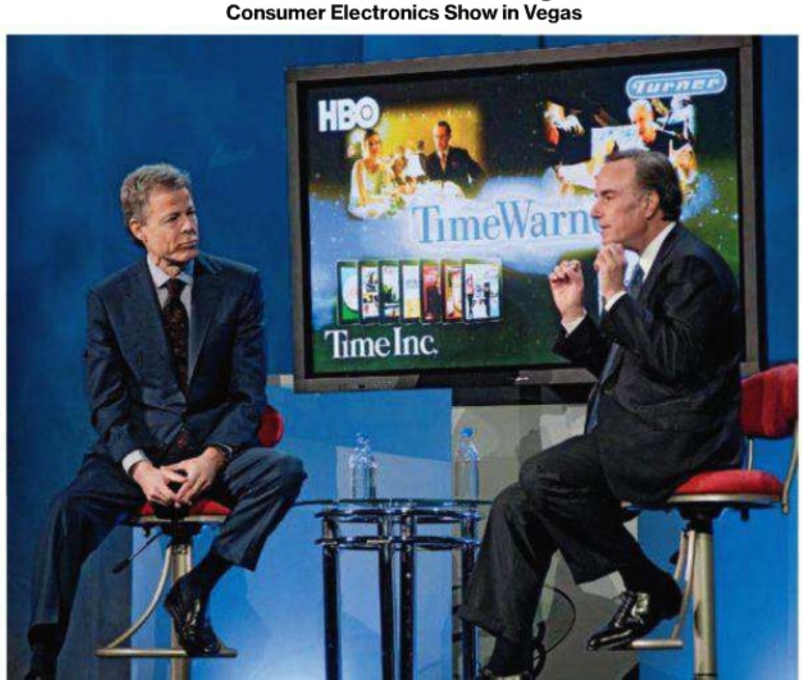
For Bewkes, 58, the solution is a Time Warner initiative called TV Everywhere, which essentially forces customers to keep paying their $75-plus monthly cable bill to access television and movie content on any Web-enabled device they choose. He first floated the idea to Comcast CEO Brian L. Roberts two years ago, and in late December, Time Warner struck a multiyear deal with the cable operator that will allow subscribers to watch all the content from its basic cable channels–including TNT, TBS, CNN, and Cartoon Network–via Comcast's Xfinity service. Digital access for HBO and Cinemax customers will be available in 70 million homes by the second quarter, he says. Verizon FiOS, AT&T, DirecTV, Dish Network, and Time Warner Cable are also expected to roll out versions of the TV Everywhere concept in coming months. Bewkes wants other media companies to offer the same all-or-nothing Web menu, arguing the only way to win the digital war is to "keep it simple, stupid."

Then again, rival approaches to distribution–from the à la carte menu championed by Apple's iTunes store to the cheap monthly subscription model of Netflix–are pretty simple, too. With the health problems of Apple CEO Steve Jobs compelling him to step down for a third leave of absence, his influence must be measured not just across the computer, phone, and device businesses but across the media distribution business as well. In part it can be measured by the model Bewkes is fighting against: Call it the Apple Trap. Consumers enjoy watching shows for free online or going to the iTunes store and renting them for as little as 99¢ a pop, about 70¢ of which makes it back to the content creator. Since that is far less than what other distributors pay, Bewkes is no fan of it. He won't play the 99¢ rental game for first-run fare, but he is willing to sell episodes, charging a premium for HBO content. "I've talked to Steve Jobs quite a bit," he says. "I tell him if he wants to sell our content, he has to pay a fair price for it."

Bewkes' price doesn't start at a buck. The man who built his career over 23 years at HBO will not make his hit movies or shows available for cut-rate streaming at Amazon. Nor will he offer them for instant viewing at Netflix, where CEO Reed Hastings recently rolled out a $7.99-a-month deal for unlimited streaming of TV shows and movies. And Bewkes certainly won't let his product be given away on Hulu, which distributes most of its advertising-supported programming for free. Netflix has wooed more than 16 million subscribers, usually paying a fraction of what cable and satellite owners pay TV channels to run content. And while about 70 percent of the ad dollars Hulu takes in gets back to the content owner, those online ads don't draw anywhere near the audience or revenues of TV. That's why Amazon, Netflix, Hulu, and iTunes are potential enemies to Bewkes. He holds the view that companies such as Time Warner can only continue to make high-quality content if they preserve a business model that requires consumers to pay for the whole buffet. Any Web distributor can stream his content, says Bewkes, "if they pay us a billion dollars for a marquee show."

If the situation is so black and white, however, why have Bewkes' rivals been willing to test new distribution models? News Corp., Viacom, and NBC Universal, among others, have experimented with

Bewkes and Verizon CEO Seidenberg at the Consumer Electronics Show in Vegas





PREVIOUS SPREAD: DANIEL ACKER/BLOOMBERG; THIS PAGE: JACOB KEPLER/BLOOMBERG

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different ways to do business on the Web. Walt Disney has been the boldest, perhaps because board member Steve Jobs is its largest shareholder. Disney has the broadest range of offerings on iTunes and last year struck a deal to rent ABC shows for 99¢ each. News Corp.'s Fox network is in a six-month trial to rent hits like *Glee* at the same price. Both networks are partners with NBC Universal in Hulu, which launched in early 2007 as a way for TV networks to combat the piracy that gutted the music business. "When I took this job four years ago, the words Hulu, Netflix, Google TV, and iTunes were not part of the lexicon," says Jeff Zucker, the departing boss of NBC Universal, now merging with Comcast. "And now, frankly, it's all we think about."

These days on the digital battlefield, it's hard to tell who's a friend and who's a foe. There's the advancing army of Boxee, Roku, Slingbox, and other new services that make it easier to find and stream content. Google and Cisco Systems are getting into the game of connecting the Internet to the home TV; so is Microsoft with its Xbox console. Bewkes views all of them as potential allies in helping people find his shows—but not if they dare to sell their own ads around them. Verizon's Seidenberg argues that Bewkes' obstreperousness makes him an innovator. "If we do this right," he says, "we can work with all the content companies to create a responsible transition to new platforms."

It's understandable that media moguls such as Bewkes don't want to disrupt relationships with TV distributors that have been lucrative for so long. But Boxee CEO Avner Ronen, whose company makes software that lets customers watch Net content on their TVs, predicts the world will move to a model where consumers will pay one price to get a distribution service and another for the content they actually want. Companies such as Time Warner "need to take all their amazing content and be aggressive in engaging with the new technologies. Of course they should be paid. They have to cover the costs to make it." Adds Michael Pachter of Wedbush Securities: "The guys who will ultimately profit the most in the new environment are the ones who own the content."

So far, however, assembling the technologies and players needed to implement TV Everywhere has been a challenge. Rival studios enjoy the extra income and reach that Apple or Netflix distribution can bring. Distributors would love to lower the fees they must pay to carry a range of channels, many of which their customers don't really want. Fox Filmed Entertainment co-Chairman Jim Gianopulos says rolling it out isn't so easy. One concern is how to give a subscriber online access without letting the entire dorm use that account to stream episodes of *True Blood* onto everyone's laptop. "Any time you try to arrive at a standardized set of rules or content-protection standards across an industry," Gianopulos says, "there's cacophony before there's order."

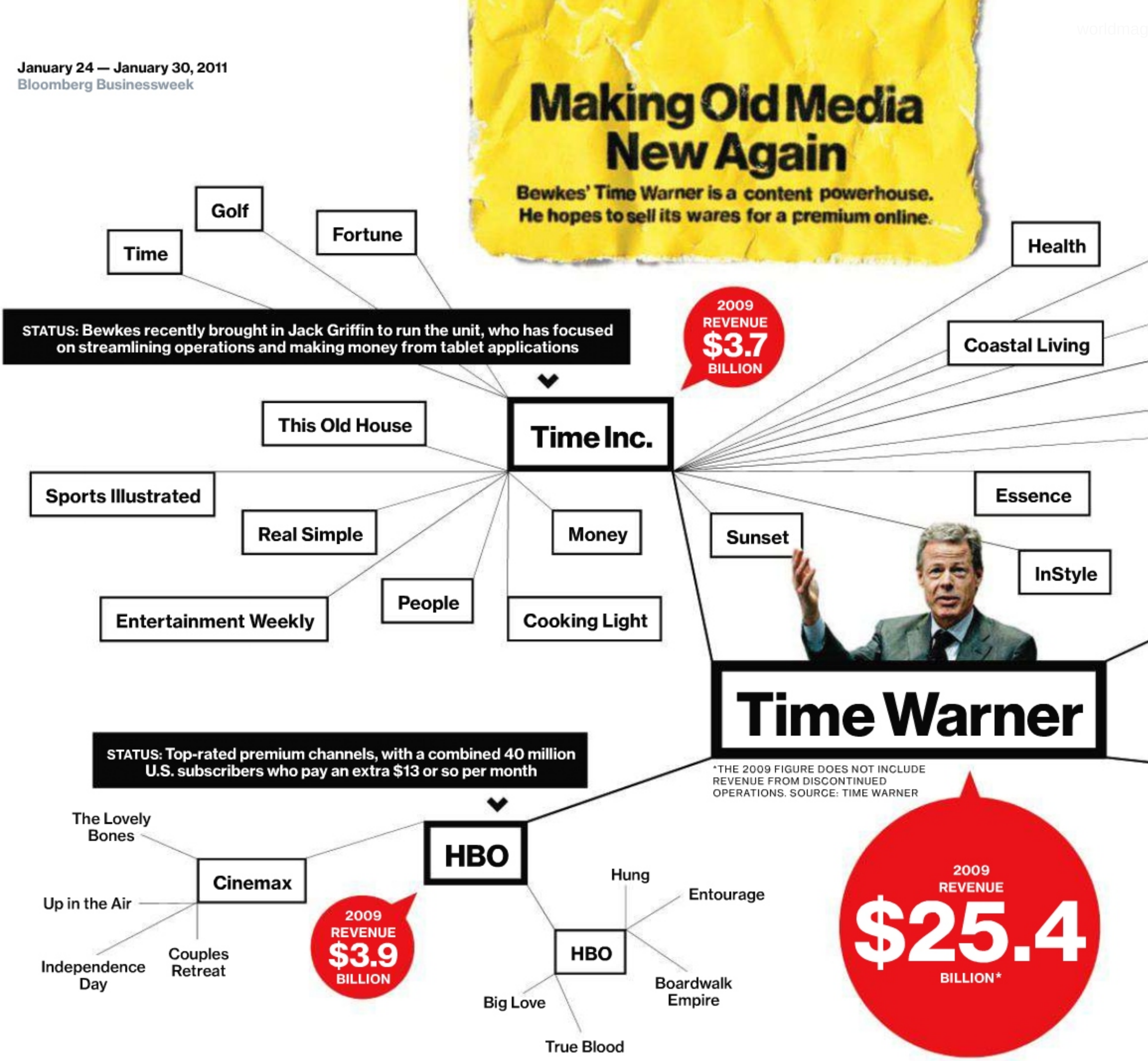
If the noise bothers Bewkes, he doesn't show it. At CES he's almost buoyant. When a TV reporter describes Netflix as an 800-pound gorilla, he says it's more like a "200-pound chimp." When he runs into DirecTV CEO Mike White, he gives a thumbs-up and declares that "satellite is good!" He notes with satisfaction recent increases in TV viewership and ad rates, along with an explosion of high-quality programs he calls "a new golden age of television." He can also point to his company's results as a sign of survival. Bewkes lost about 1.5 million subscribers at his Cinemax and HBO channels last year but says most were on free promotions. Despite a tough economy, close to 40 million households still pay about $13 extra each month for the premium services. With Time Warner expected to report on Feb. 2 that 2010 earnings grew 3 percent while revenues rose 2.9 percent, to $26.5 billion, Bewkes can claim that his content remains king—at least for now.

Content is all he has left. In his three years as CEO of Time Warner, Bewkes has whittled down his company, spinning off Time Warner Cable and AOL, closing 34 magazines, and folding New Line Cinema into Warner Bros. What remains is about 43 percent smaller in revenues and focused squarely on content in the form of HBO, Warner Bros., the Time Inc. stable of magazines, and Turner Broadcasting's cable channels. Almost three-quarters of Bewkes' operating profits in 2009 came from the cable networks, with subscription fees making up 64 percent of that unit's revenues and ad sales supplying the rest. 83

Bewkes believes the TV Everywhere model can revive his sluggish magazine business. He wants print subscribers to get the same content on the Web without being forced to pay twice. Time Inc. struck a deal with iTunes to adopt that model for *People*, but Apple won't allow it for any of its other titles. That creates yet another source of tension with Apple, which prefers to sell separate digital editions on iTunes and take its usual 30 percent cut. (Apple declined comment.) Also troubling, for Time Inc. CEO Jack Griffin, is Apple's control of the process. "You never want to let another party get between you and your customer," he says. "Everyone should be able get what they paid for on whatever device they want."

Hulu, in Bewkes' view, undermines the value of current programs on TV. "Are you testing the proposition that if you give people their favorite shows without commercials, they'll like it? I can tell you: Yes. Yes, they will." (Hulu does in fact show commercials.) NBCU's Zucker, a Hulu founder, says his philosophy was to experiment "but not bet the entire ranch on any one form of digital distribution." And there's always divorce. Viacom chief Philippe Dauman pulled Comedy Central's *The Daily Show* and *The Colbert Report* from the site last March. "We

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said, 'Great service, but the economics aren't quite there yet; come back to us when you have a different model.'"

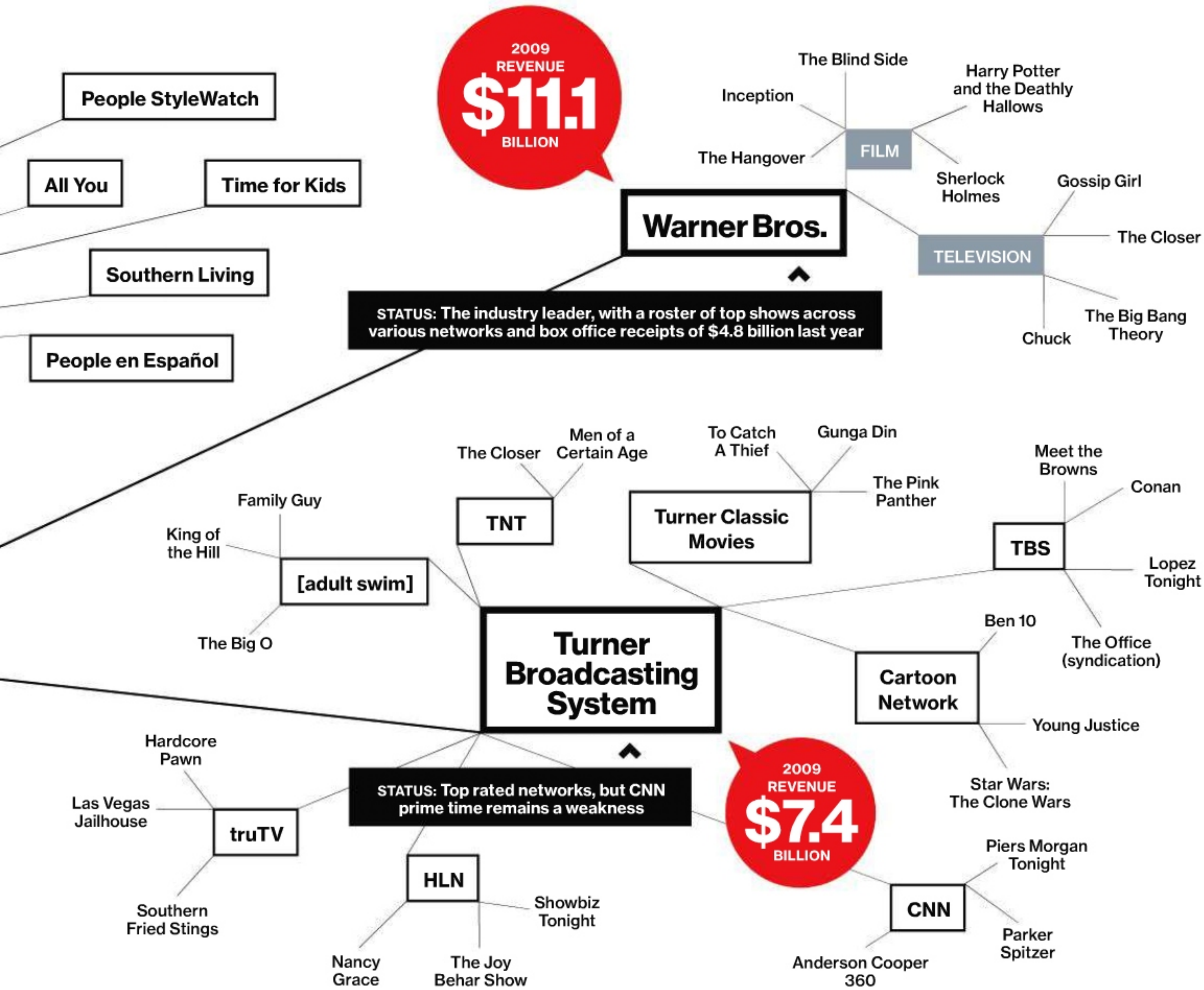
Bewkes saves his real venom for Netflix. Speculating about its dominance, he told *The New York Times*, "is a little bit like, is the Albanian army going to take over the world?" Yet it poses the greatest threat to HBO. By letting customers stream unlimited movies or shows for a small fee, it could make the pay channel obsolete. Bewkes says it's feeding off the ignorance of content owners who are risking their core businesses in exchange for modest fees. Hastings declined to comment, but Netflix spokesman Steve Swasey noted that "Netflix adds new money to content owners whereas other ventures do not." He points out that the service carries some Time Warner content, such as the Warner Bros. series *Nip/Tuck*. Studio chief Barry M. Meyer says he's happy to offload niche shows that can't be sold elsewhere but not his hits.

Bewkes says a growing number of content companies are waking up to the perils of the new low-cost Web channels. "For a year, they had some young digital-rights VP selling this stuff for an extra 10 percent, and people said, 'You should give little Freddy a bonus because he made some extra money,'" he says. "Meanwhile, someone realizes he just sold TNT a series for $2 million an episode that can be shown two times a week, and Freddy sold the same rights for $200,000 to a website that can run it day and night." There go your syndication deals and DVD sales, he says. Turner Broadcasting System CEO Philip Kent, for one, let USA Network outbid him for the right to syndicate the hit *Modern Family* because he felt it had been overexposed online. To stoke audience appetite, HBO chief Bill Nelson says, "We wait a year or more after airing a show to issue it on DVD."

Netflix stock rose almost 220 percent last year, while Time Warner shares underperformed the market, rising a little more than 10 percent. As Bewkes sees it, a great website and low-paying subscribers don't add up to a healthy business. "We've all seen this movie before," he says. "It was called AOL."

It's a telling quote—as Bewkes intends it to be. After all, he sealed his reputation as a tough executive by standing up to the leaders of AOL after the Web company merged with Time Warner in what became

JONATHAN ALCORN/BLOOMBERG



known as the worst corporate marriage in American history. Announced in January 2000, the merger valued AOL Time Warner at $350 billion, the bulk of which came from AOL's market cap. Within two years the deal that had been hailed as an Internet rescue of old media had failed, losing two-thirds of the original valuation. Bewkes was still running HBO when he showed his mettle in a 2002 meeting recounted in Alec Klein's book *Stealing Time*. Steve Case, the AOL co-founder who was then AOL Time Warner chairman, was extolling the importance of corporate synergies when Bewkes interrupted. "This is bullshit," Bewkes said. "The only division that's not performing is yours."

That Bewkes would turn out to be so tough was not a given. The second of three boys, he grew up in a family of achievers that moved around commuter towns in New Jersey and Illinois before settling in the moneyed seaside community of Darien, Conn. His grandfather had been president of St. Lawrence University, a private liberal arts college in upstate New York, and his father was a top executive at conglomerate Norton Simon before becoming chairman and CEO of American Bakeries. The family's wealth was understated, a friend says, and the dinner table was a place for good manners and intellectual debate. The Bewkes boys were steered toward pursuits such as skiing and windsurfing, according to James Angell, an artist who roomed with Bewkes at Yale University. Team sports were shunned. "His family considered the level of intelligence inversely proportional to the number of people on the field," says Angell. While "you wouldn't call them touchy-feely," he adds, "they were quite funny."

Bewkes' path to success was well mapped. He spent his high school years at Deerfield Academy, a prep school founded in 1797, then moved on to Yale, studying a little bit of this and that—"pursuing my interests without regard to a careerist pigeonhole," as he told the dean who insisted he declare a major. (He picked philosophy because that's where he had the most credits. Later he earned a Stanford MBA.) Christopher Isham, a fellow Yalie who's now the Washington bureau chief for CBS News, describes their group of friends as having "a certain strain of irreverence."

It's a strain he still displays today. Bewkes will happily riff on the finer

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CEO Hastings in Toronto last year at the first launch of Netflix outside the U.S.

points of paint color and stonework in ancient Rome for several minutes before settling back in his chair and adding, "We're very busy here at Time Warner." David Chase, who created *The Sopranos*, recalls one Bewkes speech in which he talked about trying to learn Yiddish at the age of eight so he could break into show business. PepsiCo CEO Indra K. Nooyi, who serves with Bewkes on the Yale board, says he often has the other board members "rolling in laughter" at meetings. "He doesn't operate from a place of fear," says Chase. As head of HBO, he says, Bewkes gave the go-ahead for *The Sopranos* even though its pilot didn't test well. He showed the same confidence in questioning the wisdom of AOL Time Warner when the dot-com people were still in charge and few inside the company would risk their careers by speaking up. "Jeff was clearly echoing the sentiments of everybody on the Time Warner side," says Richard D. Parsons, who was then the CEO. "He was never intimidated by the AOLers."

When Bewkes took over from Parsons in early 2008, he immediately began to break apart the company. First he spun off its 84 percent-controlled cable operation, which gave Time Warner $9.25 billion of extra cash when the deal closed a year later. While the cable business wasn't broken–its stock has outperformed its former parent–Bewkes didn't want a $17.2 billion-a-year distribution business with high capital costs. Glenn A. Britt, a long-time colleague of Bewkes' who's now CEO of Time Warner Cable, says the executive team agreed the businesses were better off apart. "I was always more into cable and technology," he says, "whereas Jeff was more into content." As for the confusion created by now having two companies with the same name, Britt points out that "we were the only part of Time Warner that used the name to do business." Since taking in the cash payout from Time Warner Cable, Bewkes has spent roughly $1.6 billion on dividends and $2.7 billion on stock buybacks–a conservative play, for sure. The company had $4 billion in cash on hand in September, its most recent filing.

Next, Bewkes turned his attention to the dysfunctional AOL. Its core business–selling dial-up Internet access to 26.7 million subscribers at its height–had gone the way of the buggy whip. In March 2008, Bewkes made his biggest strategic gaffe, spending $850 million to buy a social network site called Bebo. A year later he brought in Google ad executive Tim Armstrong to run AOL, and Armstrong eventually sold Bebo at a fraction of its original cost. ("You can call that one a failure," Bewkes says.) Armstrong had plans to turn AOL into a content company, but Bewkes cut it loose in December 2009, giving Time Warner investors one AOL share for every 11 TWX shares they owned in a deal that valued the denuded Web player at $2.5 billion.

That sale is essentially what activist shareholder Carl Icahn was pushing Parsons to do in 2005. "I wish it had happened earlier," says Icahn, who also suggested spinning off Time Inc. "Jeff has done a real good job." Fund manager David Giroux, who holds 10.4 million Time Warner shares though the T. Rowe Price Capital Appreciation Fund, is more impressed with what Bewkes is doing now. Giroux describes him as "the first person to realize that giving away your content for free is not a good business model." Bewkes' preference for buybacks (and the richest dividend in the media business) over acquisition pleases Giroux, too. That said, Bewkes confirms that he's looking into buying assets from Doğan Yayin Holding, Turkey's largest media group, if the price and political climate are right.

Taken together, the company calculates that return to shareholders from the three former parts of the empire rose about 13 percent during Bewkes' first three years on the job. Returns from Time Warner alone were up only 1.9 percent, according to Bloomberg data. That places Time Warner between the performance of Disney (up 21 percent) over the same period and rivals such as CBS and News Corp. (down 21 percent and 26 percent, respectively). Lead director Frank J. Caufield says he's pleased. "The entire board thinks Jeff has done an extraordinary job," says Caufield. "He has a consistent vision, and he's aggressively pursuing it."

Because Bewkes is known as a practical, shareholder-focused man-



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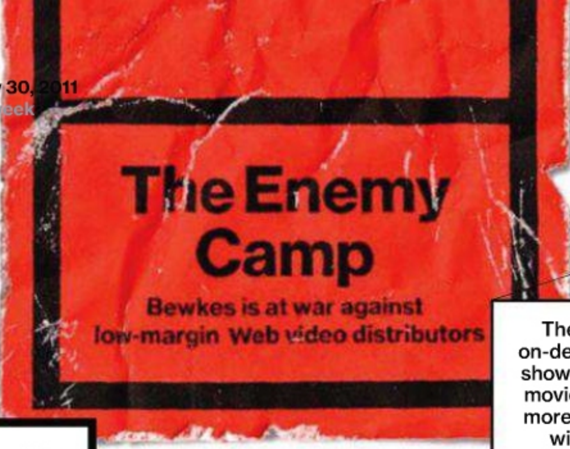
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Amazon

The behemoth of e-commerce has a growing video-on-demand business, with more than 75,000 movies and shows to stream. It sells TV episodes for as little as 99¢; movies can be rented or owned. As streaming becomes more popular, Amazon will likely compete head-to-head with Netflix. Look for a subscription service linked to membership in its Amazon Prime shipping program.

Netflix

First its DVD-by-mail business crushed Blockbuster. Now, Netflix is threatening to upend the cable universe with a $7.99 monthly package that lets customers watch thousands of unlimited movies and shows over the Internet on almost any device. Bewkes lets it stream niche series not sold into syndication but says there are no plans to add HBO content to that menu.

Hulu

Founded in March 2007, Hulu's owners include NBC Universal, News Corp., and Disney. The ad-supported site is popular, with more than 2 billion videos of its hit shows and movies streamed in December. But with 2010 revenues in the $260 million range, according to CEO Jason Kilar, its new $7.99 Hulu Plus premium service may prove key in determining the website's future.

Apple

Although devices from its iPads to iPhones fuel sales, Apple is a giant in the online entertainment realm. It's closing in on 10 billion downloads from its App Store and offers everything from movies to magazines via iTunes. But Apple's low-cost à la carte model is a nightmare for content producers, who worry that it will wreck margins and devalue other distribution channels. Other than Fox and Disney, whose largest shareholder is Steve Jobs, few content players are willing to experiment with renting hit shows. Still, it's hard to resist the reach that Apple offers.

ager, some describe him as cautious and conservative–a "numbers guy" and even a "sensible technocrat," in the words of a *New York* magazine profile. (Bewkes calls the label "better than some of the alternatives.") Don Logan, a former Time Inc. chief who shared operational duties with Bewkes when Parsons made both group chairmen in 2002, praises him as an analytical boss who "doesn't put a lot of layers between himself and the people in the field." When he took over the top jobs at HBO and later Time Warner, Bewkes didn't replace himself as COO.

That Bewkes is rarely described as a visionary is a relief to Turner's Phil Kent, who had enough of the vision thing and left CNN shortly after the merger, then returned in 2003 when the AOL side of the company was on the wane. "The business has evolved to a place where you need really smart, clear-thinking leaders who put shareholders first."

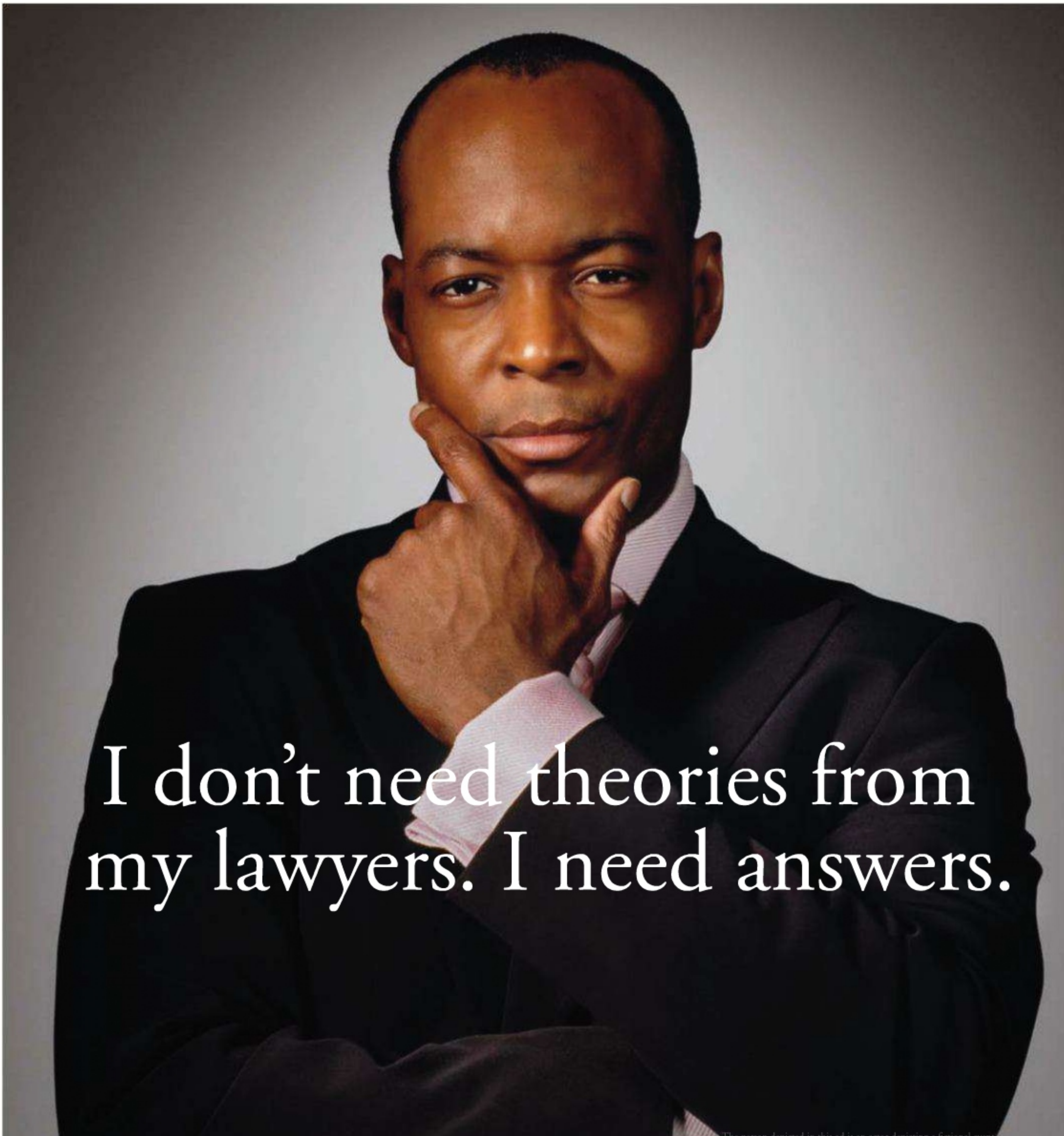
Given the flux in the media business right now, matched against the sizzle and speed of Silicon Valley, some might wonder whether a leader who stands for stable evolution may be more hindrance than help. After listening to Bewkes speak at the UBS Global Media and Communications Conference in New York last month, one media executive, who asked not to be named because of close ties to the company, admitted to feeling a little empty. What Bewkes said sounded sensible, the executive says, but he didn't offer any compelling reasons to buy the stock.

Bewkes likes to remind people that Time Warner's businesses are typically top in class, though nobody is about to brag about CNN's recent prime-time performance. There's the leading pay channel, the powerhouse production studio, the cable channels, and the magazine unit with still-profitable titles from *Sports Illustrated* to *Time* to *People*. Skeptics point out that he could have trotted out the same list of leading properties two decades ago. What's new at this company?

What's new, Bewkes says, is defending what's old. In a world where Time Warner content is everywhere, the company is still getting paid for it. If he succeeds in keeping that world alive, Bewkes will be justly hailed, if not for his vision, then for his intransigence. Back at the electronics show in Las Vegas, Bewkes is ever vigilant. At the Samsung booth, he spots Britt, chief of the spun-off Time Warner Cable, and motions to a reporter. "Come here," Bewkes says. "We liberated this guy." As Britt shows off some new Samsung technology that gives subscribers a snappy interface and no need for a set-top box, Bewkes has just one question: Will anyone be able to shrink that screen and sell ads around Time Warner's content? An exasperated Britt shakes his head.

Bewkes has to go, but he wants to show that he cares about the football fields of new tablets, smartphones, and other gadgets on which his content increasingly appears. So he turns to a colleague at the Samsung booth, Warner Bros. chief Barry Meyer, and says, "Barry, don't leave without seeing all the other stuff." Meyer nods in mock deference, promising to inspect no fewer than 13 other devices, all with different-sized screens.

Until Bewkes is comfortable that each of those screens will more than cover his costs, he might be right to hold the line on digital distribution. It isn't brash, but it may be effective. "In times of crisis, Americans tend to default to action," says analyst Laura Martin of Needham. "Maybe Jeff, in taking no action until it makes sense, is being more innovative than you'd think." Ⓑ



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Steal This Look!



Monique Erdman , 14
Shorts $15.80
/////////
"I come once a week, twice if I'm lucky"



Madeline Peters, 13
Jeans $27.80



Madison Hawksley, 13
Makeup mirror $2.80



Alexandra Collins, 18
Cardigan $17.80



Alexandra Black, 14
Sundress $10.80



Carly Peters, 18
Lace top $17.80

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Forever 21 is a fast-growing family-owned empire, offering dirt-cheap clothes for teens that could have come off a top designer's runway. Is that, like, legal?

By Susan Berfield. Photographs by Emily Shur



Kara Strickler, 18
Skirt $17.80

Shannon Dollar, 13
Cardigan $13.50,
T-shirt $6.80
Camisole $3.40

Sarah Dunn, 14
T-shirt $5.50

Lyndsey Molina, 19
Cardigan $13.50
////////
"Usually whatever is in the magazines, Forever 21 has something similar"

Lauren Iglehart, 18
T-shirt $4.50

Kelsha Wynn, 20
Bag $28

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"Their design is

The Takashimaya store on Manhattan's Fifth Avenue was spare, exquisite, and often too quiet for its own good. It closed in June. Five months later, only the Japanese department store's marble floors and high ceilings remain. The six-floor, 30,000-square-foot space has been transformed into a glittery, dizzying showplace for Forever 21, the cheap chic teen retailer with sprawling ambitions, not the least of which is wanting the grown-up world to take it seriously.

On a late November morning the day before the store is to open for the first time, Linda Chang takes a moment to contemplate her family's ambitions. "It's pretty historic that we're on Fifth Avenue," she says. "We've tried hard not to make it feel like fast fashion." Chang has recently become the slightly more public face of the very private family that owns Forever 21, and she's still feeling her way into the role. Chang is 29 with an undergraduate business degree from the University of Pennsylvania, and she's been leading the marketing department for the past two years. One day she'll likely run the nearly $3 billion, 477-store, 35,000-employee chain. For now, Do Won and Jin Sook, or Mr. and Mrs. Chang, as everyone at Forever 21 calls them, are still very much in charge. Mrs. takes care of the merchandise; Mr. takes care of everything else.

He is here today, a youthful-looking man in his 50s wearing a dark blazer, jeans, and a wool scarf. No one dares approach him uninvited. Linda is far more outgoing. "This is our rock-and-roll section: sequins, black lace, leopard, some leather, a mix of the wild things, our faux fur, crochet," she says, sweeping her arm across just some of what's on the first floor. She's dressed modestly in a Forever 21 black T-shirt and jeans with a boyfriend blazer. Her necklace, of interlocking Cs, is Chanel.

A 20-foot chandelier dangles from the mezzanine above, and flecks of gold paint shimmer on the walls. On other floors, Linda points out plaid shirts, Nordic ski sweaters, sweaters with elbow pads, military-style jackets, capes, draped work dresses. On and on it goes: Forever 21's buyers—and shoppers—expect the stores to offer every trend. "Mrs. Chang oversees all the merchandise," says Linda of her mother. "But she doesn't travel to store openings. She says: 'I'll get you the product. You sell it.'"

I notice a pair of faux-leather lace-up ankle boots that look a lot like the Jeffrey Campbell ones I'm wearing: The style is the same, so are the combination of hooks and holes for the laces and the distinctively shaped heel. Forever 21 sells the boots for $35.80, less than one-quarter the price I paid. I mention them, and Linda says brightly: "You should buy another pair here." Fashion watchers will find a lot more that looks familiar in Forever 21.

On the sixth floor, we stop in front of a revolving rack suspended from the ceiling. "That's one of my sister's favorite things," Linda says. "The clothes rotate around, and you can stop it when you want. It's from the movie *Clueless*. My sister wishes she could have one in her room." Linda's sister is Esther, who graduated from Cornell University with a degree in fashion and merchandising and at 24 is the head of the company's visual display team. She's been up all night putting the finishing touches on the store. "Esther had one week to set it up. We're fast. Everything we do is fast. We found out we had this space six weeks ago," says Linda.

The store is the third the company has opened in just two weeks and the hundredth in the past year. Forever 21 has been quick to take advantage of the misfortunes of other retailers, moving into buildings abandoned by Saks, Sears, Mervyns, Dillard's, Circuit City, Virgin Megastore, and HMV. It's staked out some of the most prestigious real estate in the world—on this stretch of Fifth Avenue, on London's Oxford Street, in Tokyo's Shibuya district. Its new Times Square store is 96,000 square feet; its store on the Las Vegas Strip is 127,000. In seven years, Forever 21 has grown from 1 million square feet of space to 10 million, from one brand of its own to six, offering clothes for kids, men, and plus-size and pregnant women. This year it plans to open at least 75 more stores in five countries. Forever 21 had a profit of $135 million in 2008, the last time it made figures public. And it did all this without selling any item for more than $60.

How did the Changs, Korean immigrants who opened their first store in a gritty section of Los Angeles in 1984, become such important players in fast fashion? The family credits its accomplishments to hard work, faith, and frugality, though Forever 21 has not prospered without controversy. The company has been accused many times of not just following the trends but selling copies of clothes created by trendy designers. Some of its suppliers, many of whom are part of a tight-knit Korean-American community of manufacturers and vendors that dominate the garment industry in Los Angeles, have been accused of underpaying their workers. Now Forever 21's expansion raises a question, both strategic and existential: When is more too much?

Forever 21's headquarters sit just beyond a dodgy patch of industrial Los Angeles, past storage facilities and auto supply stores, a taco joint, and the Score Gentlemen's Club. Headquarters is a two-story concrete building with a courtyard. The corporate offices are on the right, the merchandising nerve center on the left. They're two separate worlds. The merchandising side, Mrs. Chang's part of the building, has its own security; Forever 21 executives are rarely allowed in for fear they might distract her employees. The windows are covered with blinds. Requests from *Bloomberg Businessweek* to observe the goings-on were met with laughs by Forever 21's representatives.

"Their design is swathed in mystery," says Susan Scafidi, a professor of copyright law at Fordham University Law School and director of the Fashion Law Institute. "But it probably looks a bit like a crime scene, with the chalk outline of the garments they're copying." The Changs, for the record, have never been found liable for copyright infringement.

The warehouses are also off limits, though driving by the block-long buildings one can see stacks and stacks of boxes and racks of plastic-wrapped clothing. Forever 21 would not discuss what might be inside.

Instead, visitors get to see the inside of a bare conference room, where today Larry Meyer, the executive vice-president and the other public voice of the company, comes in wearing a Santa Claus suit. It's a week before Christmas,

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swathed in mystery," says one watcher. "But it probably looks like a crime scene"

and the company has just had a holiday party. Meyer is too pressed for time to change back into his clothes, so there he sits for the next hour, stuffed and hot.

Meyer joined the company as chief financial officer in 2001 after a career that took him from PepsiCo to Gymboree to Toys 'R' Us. Mr. Chang hired him to get the company's financial records in order in anticipation of going public. It seems improbable now: a company that doesn't let anyone into its corporate offices opening itself up to a complete inspection. The timing of an initial public offering never came together, though, and today Meyer says the company's independence is more valuable. "We get to do what we want when we want," he says.

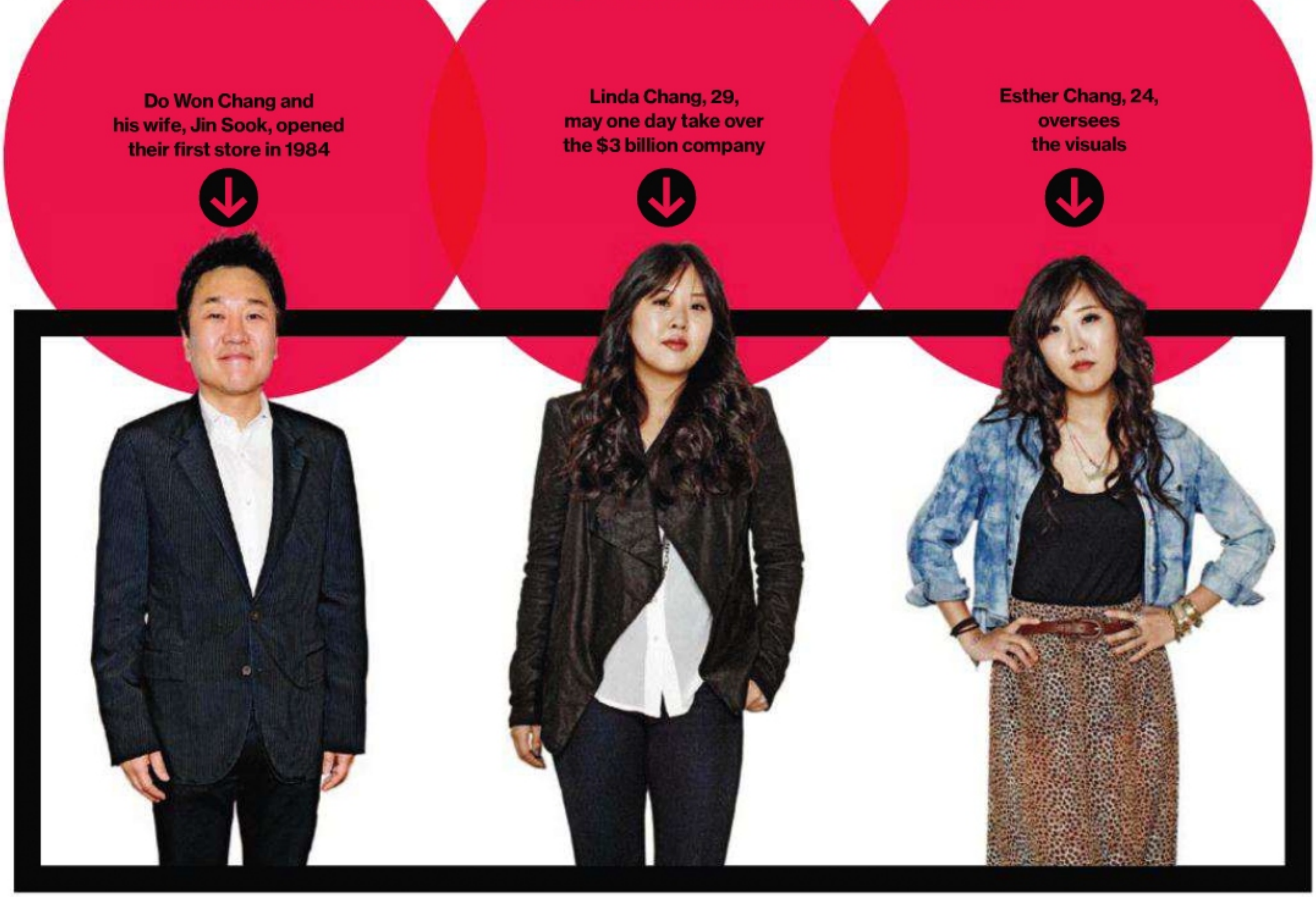
Now Meyer is in charge of the company's real estate. "We're looking for bigger spaces and better malls," he says. "We're not built for small stand-alone stores, the million-dollar stores. Our stores are higher volume. We're about energy and turnover." He continues: "Having really big stores has always been Mr. Chang's dream. He's always wanted to be a fashion department store, with clothes for all kinds of people. Now the real estate is available, and we're confident that we have the merchandise to fill it."

Big dreams have ruined plenty of retailers. "Forever 21 has excelled at doing what people didn't think possible—selling clothes as fast and cheaply as they do. But these big stores come back to haunt a lot of retailers," says Liz Pierce, a senior research analyst at Roth Capital Partners in Newport Beach, Calif. "Trying to be too many things to too many people doesn't always work." Howard Davidowitz, a retail consultant and investor, is even more concerned by Forever 21's strategy. "What they're doing is quite dangerous," he says. "Stores that size are hard to control, hard to merchandise. They're breaking all the rules. Trouble can come very quickly in this business."

Do Won and Jin Sook Chang arrived in Los Angeles in 1981 in the midst of a shift in the garment industry, as Korean and Persian immigrants began to work their way into the business. Soon an entire Korean-American ecosystem had developed, from manufacturing to wholesale to retail. It was punishingly competitive: Speed, flexibility, and hard-headedness were required at every turn. The Changs thrived.

In Seoul, Mr. Chang had started the first coffee and natural juice delivery service. Mrs. Chang had been a hairdresser. They wanted to run their own business in Los Angeles, and while subsisting on wages from menial labor (he pumped gas and worked as a janitor), they managed to open a 900-square-foot clothing store. It was on a low-rent street close to the garment district, and they called it Fashion 21. The Changs filled the store with cheaply made, skimpy clothes for teens, all produced by Korean-American manufacturers and all selected by Mrs. Chang. She proved to have a sharp eye for easy-to-copy trends and an even sharper instinct for negotiation. "My mother is an incredible buyer," says Linda. "We have long relationships with our vendors. We work hard with them, going back and forth. She's really smart about what the cost should be." Within the first year, the company says, its sales had reached $700,000.

→



Do Won Chang and his wife, Jin Sook, opened their first store in 1984

Linda Chang, 29, may one day take over the $3 billion company

Esther Chang, 24, oversees the visuals

DO WON CHANG: JAMIE MCCARTHY/GETTY IMAGES; LINDA AND ESTHER CHANG: PHOTOGRAPH BY EMILY SHUR FOR BLOOMBERG BUSINESSWEEK

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The Forever 21 on Manhattan's Fifth Avenue is designed to make shoppers forget how cheap the prices are, says Linda Chang

The Changs, who are born-again Christians, think they had some other help, too. Mrs. Chang tells people that when they were starting out, she went to the top of a mountain in Los Angeles to pray. God told her she should open a store and that she would be successful. "Every decision that they made has been with thoughtful prayer," says Linda. Mr. and Mrs. Chang attend a daily 5:30 a.m. prayer meeting at the Ttokamsa Mission Church when they're in town; he also leads Bible study, and she's a deacon. "I think they get a lot of business ideas and insight during early morning prayer time," Pastor Ken Choe says in an e-mail. According to him, they've contributed millions of dollars to missions around the world and regularly go on missions themselves, including to Afghanistan, India, and Pakistan. They've told their daughters that when they retire, they want to devote themselves fully to the church. "Mr. Chang said he would have been a missionary if this hadn't worked out," says Linda. "This supports that. This is part of their missionary vision."

The Changs' faith is often on display at Forever 21. In black letters on the bottom of every bright yellow Forever 21 shopping bag is "John 3:16," a reference to one of the best-known verses of the Bible: "For God so loved the world that he gave his one and only Son, that whoever believes in him shall not perish but have eternal life." There are Bibles at the company's headquarters. And when Mr. Chang accepted an award from the Los Angeles County Economic Development Corp. in November and gave a rare public speech, he said: "I live by the Bible verse, 'He who is full hates honey, but to the hungry even what is bitter tastes sweet.'" Then he added: "That is why I work so hard–because I'm still hungry."

Fashion 21 caught on quickly because its founders caught on quickly. "We have a lot of startups looking like their first store–whatever's hot, whatever's available, just thrown in," says Ilse Metchek, founder of the California Fashion Assn. "What's remarkable is what the Changs learned. They learned that what's new has to be up front, and it has to change daily. Most retailers stay with dead inventory too long. Forever 21 is all about movement in the store." According to Roth Capital's Pierce, a typical Forever 21 store might turn over 20 percent of its merchandise in a week, which could be twice as much as most apparel retailers.

The Changs also figured out that if they order small enough batches of each style, shoppers will learn to buy what they like when they first see it. Next week it might be gone. "Most retailers put out tons of their hot items," says Metchek. "At Forever 21 they went the reverse way–they built in obsolescence."

The Changs' first store remains open on North Figueroa Street in Highland Park, next to the Heart of Gold thrift shop and Sunny Discount Mall. It looks remarkably unchanged. It's by far the smallest and dingiest outlet in the chain: The carpet is beige and worn, the ceilings are low, the lights fluorescent. Even here a truck arrives six days a week with new clothes, and as soon as the doors open at 9 a.m., shoppers are inside.

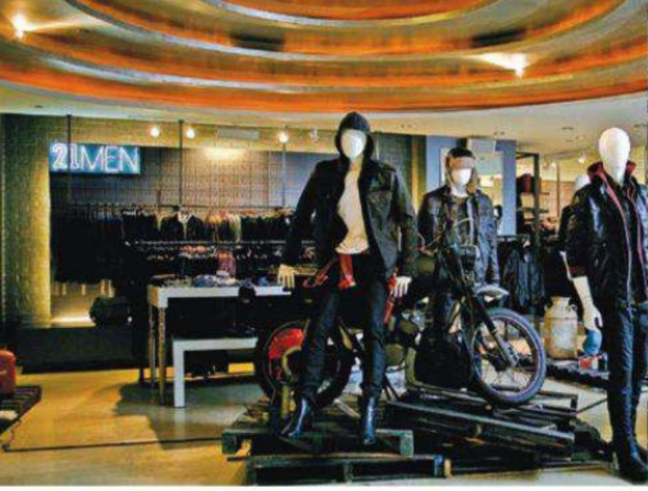
Twenty-five miles away is one of Forever 21's biggest stores, an 86,000-square-foot, two-floor emporium in Los Cerritos Center, on the edge of Orange County. It used to be a Mervyns. The space is divided into 22 mini-shops; it's a department store selling only Forever 21 brands. It has 130 fitting rooms and 24 cash registers. In the year it's been open, about 2 million people have come through its doors.

The Changs have been able to accomplish this with no advertising, virtually no marketing, and only infrequent attempts to introduce themselves to their customers. For years, their headquarters didn't bear the company name. Phone calls and e-mails from strangers were ignored. Even a local representative with the U.S. Commerce Dept. couldn't get in touch, and he wanted to talk about business opportunities overseas. "I pursued them for five years and then gave up," says Bobby Hines, an international trade specialist at the Commerce Dept., who has worked with the Korean apparel industry in Los Angeles since the late 1990s. At the suggestion of a Forever 21 store manager he knew, Hines even went to services at their church one Sunday hoping for an introduction. No luck. And he's not the only one who's had that idea. "People do come trying to talk to them," says Pastor Choe. "But after attending church services, they soon realize the church is not a place to make business contacts."

The Changs' reluctance to open themselves and their company to more scrutiny may stem from the many lawsuits they've faced. In September 2001, the Asian Pacific American Legal Center and the newly created Garment Worker Center filed suit against Forever 21 on behalf of 19 workers, alleging unfair business practices and wage violations. The workers were sewing at seven different small factories–they called them sweatshops–that had all been contracted to produce garments for Forever 21. This was just a few years after some 70 Thai garment workers had been freed from near-slave conditions in El Monte, Calif. Julie Su, the lawyer who won the women a $4 million settlement and legal status (and later a MacArthur "genius" award for herself), was the lead attorney in the case against Forever 21.

The company, like many caught up in similar allegations, said it didn't know about and wasn't responsible for the working conditions in these factories. "It's impossible to claim ignorance when the problem is so rampant," says Su. "Forever 21 is not a victim of the industry. They create and demand these con-

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ditions. They squeeze their suppliers and make it necessary for them to get things done as quickly and cheaply as possible, no matter what the cost to the workers." Meyer responds: "We have developed a comprehensive vendor compliance program requiring manufacturing facilities with which we do business comply with all applicable labor laws. … If we are notified of any violation by our suppliers, we investigate and resolve immediately."

The workers also launched a national boycott of Forever 21 in October 2001. They protested at stores around the country and outside the Changs' Beverly Hills home. The first time they gathered there was on a Sunday morning; the Changs drove off in an SUV with tinted windows. Linda was away at college, but Esther was in high school, at the prestigious Harvard-Westlake School. "It was a difficult time for them," she says by phone. "I'm sure it was hanging over my parents, but they didn't want it hanging over me."

The garment workers kept up the boycott for three years, during which time Forever 21 sued them for defamation and several of the manufacturers settled (in one instance, paying seven of the women a total of $175,400). When a judge finally ruled that the case could proceed in 2004, Forever 21 settled. The terms of the agreement are confidential. Forever 21 and the workers issued a statement that read in part: "The parties have agreed to take steps to promote greater worker protection in the local garment industry. … The parties share a belief that garment workers should labor in lawful conditions and should be treated fairly and with dignity." Three years later, a documentary about the lawsuit and boycott, *Made in LA*, was shown on public television. It won an Emmy in 2008.

By then, Forever 21 was facing a new and altogether different wave of litigation. Starting in about 2004, the Changs decided to create different brands to appeal to slightly more sophisticated and older shoppers. Over the next couple of years, labels ranging from Diane von Furstenberg to Anna Sui to Anthropologie, about 50 in all, separately sued Forever 21 for copying their clothes. The company said that its buyers had to trust its vendors and couldn't possibly know how those vendors came up with all their designs.

U.S. copyright law protects only original prints and graphics, not designs themselves, making some cases hard to prove. Von Furstenberg, Sui, and Anthropologie did win settlements, though, which also remain confidential. The legal documents are sealed now, but when they were available, *Women's Wear Daily* excerpted a reprimand of Forever 21 by the U.S. District Court judge hearing Anthropologie's case. "We note the extraordinary litigating history of this company, which raises the most serious questions as to whether it is a business that is predicated in large measure on the systematic infringement of competitors' intellectual property," Judge Michael H. Dolinger wrote on Mar. 12, 2009. Meyer responds: "The number of claims against us is relatively small compared to the number of items we sell. Now we have a process to ensure that our products do not violate the intellectual property rights of others."

"Of the various fast fashion chains, Forever 21 is the one who treats liability as a cost of doing business," says Scafidi, the copyright law expert. "Illegal copying has been incorporated into their business model. But it's not necessarily a terrible result for designers who do receive payment."

One of those designers is Virginia Johnson. In 2005, her intern spotted a skirt in a Manhattan Forever 21 with a print much like one that Johnson had sold the previous season at Barneys. Johnson's skirt went for about $175; Forever 21's version was less than $18. When Johnson's lawyer, Robert C. Edmonds, contacted Forever 21, he learned that the company had a policy in place for just such scenarios. They would pay Johnson 10 percent of the $40,000 worth of skirts they said they had sold. When Johnson rejected that as too low, they offered $9,000, which she accepted. "I was surprised how matter-of-fact they were," she says. Meyer says there is no such policy, but that "all claims are reviewed and, where appropriate, resolved after careful analysis."

The company has largely avoided going to trial. In one instance, though, Trovata, a small label in Newport Beach, accused Forever 21 of copying its unique button placements, decorative stitching, and a tag that included one of the founders' names. In May 2009, Mrs. Chang was forced to testify in the U.S. District Court in Santa Ana. This was her first—and quite possibly last—time speaking in public. From the transcript:

Frank Colucci (Trovata's lawyer): Do you know who the other officers of Forever 21 are?
Mrs. Chang: I don't know for sure.
Colucci: Well, do you know any of the other officers?
Mrs. Chang: I don't know about that matter very well.

Later in the proceeding:
Colucci: Do you know what percentage of the stock of Forever 21 Mr. Chang owns?
Mrs. Chang: I don't know.
Colucci: Do you know whether there are any shareholders other than your husband?
Mrs. Chang: I don't know about that.
Colucci: And do you know Forever 21's approximate annual gross sales?
Mrs. Chang: I don't usually ask those questions.
Colucci: But do you know?
Mrs. Chang: I don't know.

Her testimony was revealing beyond her apparent ignorance of Forever 21's operations. Trovata's lawyers

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About 50 designers have sued Forever 21 for copying their clothes

had turned up documents showing that one of the company's biggest suppliers, One Clothing, is owned by Mr. Chang's private investment firm, Too Capital. It was also the supplier that reached the $175,400 settlement with the garment workers in 2004, Meyer acknowledged. On the witness stand, Mrs. Chang said she knew nothing about the operations of either One Clothing or Two Capital. "We simply trust the vendors, and then they manufacture the garment for us. ... That's about it," she said.

Mrs. Chang also said she has a buying team of six or seven but that she approves every single garment purchase. She chooses from among the 400 or so items she sees a day. This means that if she worked a 12-hour day and did nothing else, she would have about 90 seconds to review a piece. Most likely, she spends considerably less, which might explain what Meyer says is "some of the confusion of buying from vendors."

The Trovata trial ended with a hung jury. Days before a second trial was to begin in the fall of 2009, Forever 21 and the designers came to an agreement, which is confidential.

The lawsuits have impacted how Forever 21 operates. The Chang daughters, as well as Meyer, talk about being more careful about what their buyers select. "Things are a lot better than where they were three years ago," says Meyer, when almost all of the claims were made. "We've gotten much better at our processes." Linda says Mrs. Chang is putting together her own design team to come out with original clothes for Forever 21's more sophisticated lines. The company also introduced its first designer collaboration in August, a collection of T-shirts created by Brian Lichtenberg, a favorite of Lady Gaga. "Partly we're doing more in-house design so we can ensure we don't run into these problems," says Linda. How many designers Mrs. Chang has hired, though, is a trade secret. As for how much they will actually be able to produce, that's secret, too.

Still, the question lingered of the Jeffrey Campbell look-alike ankle boots. "Oh yes, the Loggins Oxford style, we know about that one. Forever 21 isn't the only one that knocked it off," says a representative from Jeffrey Campbell Shoes. "We don't like it, obviously. But at this point we're not taking legal action. Most of the time when the style is copied everywhere, we move on. We're not making Loggins anymore." Meyer says that "as a fast-moving fashion brand, we regularly respond to breaking fashion trends, and on occasion some designers may feel that our product might be too close to theirs. But we have regular review procedures in place."

For many shoppers, being able to find cheap copies of celebrity outfits and runway fashions–wherever they can–is a matter of pride. "I look at outfits in the magazines and come here and try to copy them," says Carly Peters, an 18-year-old college student and restaurant hostess who's shopping at the Forever 21 in the Los Cerritos mall. "I really wanted this BCBG dress for New Year's. It was a sparkly, cute, one-shoulder dress. At BCBG, it was $250. The one I found here was $20." Magazines and blogs show readers how to dress like a celebrity on the cheap. The blog thebudgetbabe.com approvingly compares a $2,675 Rick Owens biker jacket worn by Taylor Swift to a version available at Forever 21 for $37.80; a Matt & Nat vegan clutch sold for $165 with a similar Forever 21 bag going for $17.80; and a look-alike $295 Alexis Bittar lucite ring for $5.80. Bittar, who was named Accessory Designer of the Year in 2010 by the Council of Fashion Designers, says: "When I won the award, I thought, great, this is like declaring I'm someone to knock off."

Meyer says that Forever 21 is also paying more attention to how its vendors conduct themselves. "We react to complaints, and if there's proof, we'll cut off a vendor if we have to," he says.

Over the past couple of years, Forever 21 has moved much of its manufacturing, to China, Pakistan, and Vietnam, among other countries. This is due in part to the changing economics of apparel manufacturing. When a trade agreement restricting garment exports from developing countries expired in 2005, many retailers accelerated shifting their production to Asia and Africa. Forever 21 now manufactures only about 20 to 30 percent of its clothes in Los Angeles, says Meyer. And that's only because some items require very quick turnarounds.

So it's still possible to see some of the micro-factories that produce garments for Forever 21. The California Broadway Trade Center sits on the edge of the garment district, across from the derelict Rialto Theater and just down the street from new lofts built in the old Union Bank. It's a nine-story building that houses at least 80 of these factories. At the loading dock, scraps of paper are taped to the wall, listing in Spanish the jobs available that day. The building looks uncared for, but not decrepit.

Some of the doors to these factories are open, making it possible to walk around unannounced. In one, on the top floor, with no company name on the door, about 30 people are sewing gray cotton vests for Forever 21 in a small, hot room. Many of them have stuffed scraps of fabric into their noses to block the particles of material floating in the air. They're just finishing up a one-week, 10,000-piece order for which the seamstresses earn about 12¢ apiece, according to Guadalupe Hernandez, a longtime garment worker in Los Angeles. If they sew 66 vests an hour, they'll earn minimum wage. The price tags other workers are attaching read $13.80. "The Changs have been wildly successful since our campaign," says Julie Su, the labor attorney. "I don't want to take away from their hard work. But they are in a position to care for the humanity of the workers who make their living possible." Meyer says that the Changs have engaged in "numerous philanthropic endeavors assisting those in need all over the world, both personally and through Forever 21."

Linda Chang has just a few minutes before she has to leave for a flight to Asia with her father and sister. Forever 21 is opening its Shibuya store in a couple of days, its seventh in Asia and its last of 2010.

"Hi, Linda dear. I decided not to change. I took off my hat and beard, though," Meyer says of his Santa outfit. "Mr. Chang just yelled at me. He has to sign some leases before he leaves."

"Things are so crazy," Linda replies. "But we're never going to let up on the pace. I don't think anyone can."

"Every day in retail is another day," says Meyer. "You never win. You live to sell the next product." Meyer spies Mr. Chang in the hallway and runs out to get his signature on those leases.

I ask Linda how much longer she thinks her parents can keep up the pace. "Nobody works harder then they do," she says. "But they are telling me and Esther to hurry up and learn." Ⓑ

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Thunderbird body, manufactured at Budd Detroit, 1955

DISASSEMBLY REQUIRED

Tearing down an American factory, ton by ton

by Paul Clemens



At Budd Detroit, the remains of a stamping press

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In May 2006, ThyssenKrupp announced that the Budd Detroit plant, built in 1919, would close by the end of the year. The plant mainly stamped out auto body parts, and, among other distinctions, had built and assembled the metal for the 1950s Ford Thunderbird. For his book, Punching Out (Doubleday, published on Jan. 18), *and from which the following is excerpted, writer Paul Clemens tracked the Budd closing and its aftermath. He spent more than a year talking to former workers and union members before the closing, watched the auction of the plant's massive equipment, and documented the disassembly of the massive press lines, which did the stamping. In this excerpt, he meets riggers, truckers, and scrap crews—the workers charged with taking apart American industry.*

It was early June 2007 when I first got into the closed plant. Though the rigging crew had been in Budd for a little more than a month by this point, I hadn't missed much. The crew was spending most of its time prepping for the upcoming auction, to be run by the Ashman Company of Walnut Creek, Calif. Along with the Ashman workers, the Detroit crew was sorting the plant's contents into auction lots. The auction preview would be on June 18, with the auction itself on June 19 and 20.

There were 1,242 lots included in the Ashman Company catalog. Excluded were three large press lines, tagged "Not in Sale," that had already been sold overseas. These were 2-line, sold to Delga, a Brazilian auto supplier, and 9-line and 16-line, sold to Gestamp, a Spanish auto supplier that had, in turn, contracted Müller Weingarten, a German press maker, to help oversee 16-line's dismantling in Detroit and its installation in Mexico in the fall.

I went to the Budd plant as often as I could—weekends, mornings, evenings, vacation days, holidays, lunch hours. At first, with the rest of the crew, I parked in the plant parking lot, beneath the "ThyssenKrupp Budd Detroit Plant" sign. At the end of the day, some guys would strip down to their underwear in the lot, removing their work clothes so as to not get their cars' interior dirty or dirtier. Almost everyone switched from shoes to boots and back again before leaving, and many were sure to scrape the goop from the bottoms of their boots with metal rods.

Parking in the lot meant that I got to pass through the plant's turnstiles—an act not without emotional pull. This was working-class kitsch, but kitsch can be affecting. I listened for the factory whistle and regretted my lack of a toolbox or lunch bucket to lug.

On me, instead, were a notebook and pencil (come winter, ink could freeze in the plant's cold), a tape recorder and batteries, and occasionally a camera. The notebooks that I filled from early June 2007 through late April 2008 constituted my journal of the plague year. I told those who wondered at my presence I wanted to see what happened to an auto plant right after it closed—to its equipment, its people, and

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to the old plant itself, the product of an industrial era that would leave behind ruins to rival the Romans. That first day, Jeff Jinerson, the first rigging crew leader, took me around, the two of us touring the closed plant on a golf cart. Jeff was forty, lean and rugged despite some hard living. He often wore a Jägermeister bandanna. He smoked continuously.

Jeff's smoke-cured voice didn't just make sounds; it produced decibels. A terrifically talented rigger—"rigger" being the general term for the men, mostly, whose job it is to move immensely heavy stuff—he could function at near-optimal levels no matter what. "I was born and raised in a pile of grease," Jeff told me by way of introduction. He was the grandson of a boilermaker and the son of a press repairman who owned the grease pile, American Welding and Press Repair, in which he had been reared. "I spent seventeen years putting s--t in," Jeff said of the presses he'd installed, "and I've spent the last ten taking it out." Budd was the largest such taking-out job he'd done. "I'm running a 1.8 million-square-foot facility—water, power, elevators—everything, minus production."

That very morning, Jeff said, his crew had begun to take apart 16-line, bought by Gestamp for installation in its Aguascalientes (Mexico) plant. There was so much work to do that Jeff was looking to bring on four more skilled riggers. Starting pay, he said, was $22 per hour. Jeff called the Budd plant's old presses "world-class," meaning by American standards they weren't much, but first-rate to much of the rest of the world. "We're clear-cutting the forest," Jeff said to me sometimes. Budd, in this metaphor, was just one of the trees being felled in a great industrial forest, one centered geographically and symbolically on the city of Detroit but spreading through parts of Wisconsin, Illinois, Indiana, Ohio, Pennsylvania, and New York State, and known as the American Rust Belt. Later that summer, splinter crews would leave Detroit to dismantle presses at the bankrupt auto supplier Tower Automotive's plants in Upper Sandusky, Ohio, and Kendallville, Indiana. By winter, crew members from Detroit would be in Newton, Iowa, to cut up presses in the closed, iconic Maytag plant.

Standing in the center of the press shop, 16-line had been the Budd plant's biggest line, with several of its presses having been shipped to Detroit from Budd Philadelphia in the 1990s. It had produced body sides for Ford's large SUVs: the Ford Expedition, the Lincoln Navigator, and the Ford Excursion. Gestamp had bought seven presses for its expanded plant in Aguascalientes—seven presses that needed to be dismantled and trucked 2,000 miles from Detroit to central Mexico. It was early June; the line's disassembly would take until mid-November 2007.







Clockwise from upper left: riggers before a fire built from items found in the plant; preparing to move a press; the press line

PREVIOUS SPREAD AND THIS PAGE: COURTESY PAUL CLEMENS

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1995 Ford Explorer, parts by Budd

"I GIVE THEM THE VIDEO SO THAT, WHEN THEY DIE, I CAN SLEEP AT NIGHT." HE POINTED TO A SKELETON. "THAT'S OUR SAFETY MASCOT, UP THERE IN THE CORNER"

The rigging company's first makeshift headquarters in the plant were on the second floor of the central maintenance building, in the old Budd Employee Involvement Center. Amid slogans of corporate self-improvement ("No One Knows Your Job Better Than You. Only You Know How to Make Your Job Better") were a TV and VCR, along with videos such as *Mechanical Maintenance Training: Rigging and Lifting*. These were shown to new guys on the crew. "I got cherries to pop," Jeff said. "I give them the video so that, when they die, I can sleep at night." He pointed to a skeleton. "That's our safety mascot, up there in the corner."

Beneath the skeleton, leaning against the wall, was a poster sized aerial picture of the plant as it appeared on Mar. 18, 1940. To the plant's east, the blocks that are visible are dense with housing, though the postwar building peak is still a few years off. Each Saturday at noon, Jeff said, he had a barbecue for the crew on the plant roof. Seen from above, the surrounding neighborhood looked a bit different now. It was full of empty lots, resembling missing teeth. "It looks like a crackhead's mouth," Jeff said.

The Budd auction was the only public event to be held in the plant post closing. If you wanted to see its insides, this was your chance.

Out-of-state license plates were common in the parking lot during the auction's three days. Missouri, Wisconsin, Kentucky, Indiana, Tennessee, Arkansas, Ohio, and Ontario, the Canadian province Detroiters consider a suburb, were all represented.

The first day was the auction preview, at which prospective buyers were allowed to see up close the equipment that might have caught their eyes in the catalog: mechanical presses, power shears, mills, lathes, grinders, band saws, boring machines, radial arm drills, drill presses, blast cabinets, threading machines, robotic welders, arc welders, radial arm saws, planers, air compressors, cooling towers, boom lifts, forklifts, hydraulic lifts, and a whole bunch else under the technical term "Misc."

My favorite item, Lot 354, was a mammoth 1979 LeTourneau, a 132,000-pound capacity diesel forklift taller than a small-town courthouse. Included in the catalog under the section "Rolling Stock"–stuff with wheels, that is, such as forklifts, tractors, electric carts, floor sweepers, floor scrubbers, and fire trucks–the LeTourneau had been used to carry dies when the plant was active. Too big to move, it simply sat there. Nine months later, as the crew's time in the plant was coming to a close, guys discussed driving it off of the plant property and down the road, an idea that overhead power lines, lower than the LeTourneau's height, would have made tricky. Three years later, the LeTourneau still sits outside the plant, a symbol of Detroit itself: a big thing with a French name that no one can quite figure out what to do with.

The preview and auction were like an estate sale for men. Jeff Jinerson called it a "boys' day out." (I saw one woman in the plant in three days.) Instead of going through the dead widow's jewelry, hundreds of guys rooted around in the closed plant's presses, mills, and lathes. "Can you imagine what the place looked like in the Fifties?" a guy in a gas station uniform asked, of no one in particular, the day of the auction preview. We were standing in the inspection area, checking out Vernier calipers (Lot 144), Starrett bore gauges (Lot 173), and Brown and Sharpe micrometers (Lot 157). The inspection tools were many decades old; a majority came in inlaid wooden cases. "Things were labor-intensive back then," the gas station guy said. "Everything manual. You needed the people."

To Jeff, the crew leader, none of the stuff in the auction was of the slightest interest. His focus was the disassembly of those press lines, tagged "Not in Sale," that had already sold and were destined for far-off lands. "My job," he said, "is to get the stuff loaded onto the trucks."

His lack of interest in the Budd auction did not extend to the Budd plant itself. For Jeff, the plant was full of friendly ghosts. He was sentimental about it, collecting photographs, plaques, buttons, and anything else that had been left behind with the Budd name on it. (No one was touched, for some reason, by the ThyssenKrupp letterhead still scattered about: "Das Beste. Von uns. Für uns.") As a souvenir, Jeff gave me a Frisbee he'd found on the floor of his electric cart. Covered in decades of grime, it carried the logo of UAW Local 306 and, in a red-lettered circle around the Frisbee's center, said: "I Believe in Budd Detroit."

"I got a bunch myself," Jeff said.

The auction started the next morning. Inside the plant, I was given a ride to Lot 1 by Walter, a Mexican from the Ashman Company who had use of a cart. The first of the twelve hundred lots was less than thrilling: "(3) Barrel Cart, Floor Magnet, & Shop Vac." In charge was the auctioneer, Lloyd Ashman himself, whom I'd seen and heard practicing the day before. He hovered over the action, standing at an elevated podium atop a Motrec cart. While the patter of the auctioneer is ancient, or seems so, the wraparound mike he wore was that of a modern pop star.

There was no skipping ahead. The group moved, en masse, from lot to lot, sequentially. Walter, my driver, served as the auction's sighter, acknowledging bids with a quick yep. Another worker stood above or next to the lot being auctioned, holding a sign with a red arrow that said: "This Lot Is Being Sold."

To a former Catholic school kid, the process was akin to doing the



A bumper sticker found at the plant

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← A flyer from the final auction

Stations of the Cross with a priest who talked terrifically fast and who would walk us through twelve hundred stations rather than fourteen. One obese fellow, not up to all the walking, moved from lot to lot on a rolling chair, propelling himself with his feet like Fred Flintstone.

A few of the bidders looked flush, dressed in khakis and oxfords and fiddling with their cell phones. More common were the blue-collar guys who had their eyes on an item or two for their machine shop downriver or their tool-and-die place out in Macomb County. They wore dirty work pants and work shirts with their names patched on the front. Their T-shirts said things like "Lincoln Park Boring."

By Lot 80, it was time to move the cart and podium some twenty yards, for improved proximity to the upcoming lots. Fred Flintstone scooted along; the rest of us walked. By Lot 85—"Rack w/ Assorted C-Clamps"—Mr. Ashman was cracking jokes. "I don't like anything we've just sold," he said, "but this is a nice lot." For a while thereafter, I'd attempt to keep score, marking my auction catalog's columns with dollar amounts: "$10,000," "50K," "$85."

I soon stopped, too tired to tally. By afternoon, bidders were looking for a relatively clean place to relax. Some sat on the Yale and Caterpillar hi-los—Lots 392-420—that had been grouped together north of the press shop and had yet to be auctioned. The selling off of Budd equipment required stamina from buyers and sellers both. The man in the chair, it seemed, had been through this before and knew about pacing.

Later in the summer, Matt Sanders, the rigging foreman, gave me a spreadsheet, dated July 24, 2007, that outlined the transportation of 16-line's heavy parts. The five weeks from early August through early September were to follow a similar pattern, beginning with the shipment of the crown, then the slide, then the bolster, then the upright left column, and the upright right column. The estimate was that 120 truckloads would be required to get the line to Mexico.

Matt was bearishly friendly. He'd endeared himself to me right away when he sized me up and asked, "When can you start?" I wasn't capable of working on his crew, but I liked him for flattering me nonetheless.

Matt had brown hair and a bushy copper mustache a week shy of being walrus-like. One of his fingers, years ago, had gotten chopped; he showed me where it had been reattached. The stitching was nearly unnoticeable. "The doctor did a good job," he said.

One hot Saturday afternoon, I stood with Matt in Budd's old human resources offices, on the second floor of Independence Hall. Matt puffed away at his cigarette, Chrysler's Jefferson North Assembly Plant visible out the window behind him.

Matt saw a falling off not only in the country's industrial production—his presence in the closed Budd plant testified to that—but also in its capacity to dismantle the plants that were no longer producing. It was industrial decline in its second declension. "The s--t me and Jeff do, it's a dying trade," he said. "When we're gone, you're not gonna find a good rigger, you're not gonna find a good welder, you're not gonna find a good machinist. Nobody wants to do it anymore. Guys who don't mind getting dirty and actually want to throw their back into their job, they're getting to be few and far between. At the end of the day most days, I got a sense of accomplishment. I walk outta here, and you can physically see—'That big son of a bitch was in the air, and now it's down on the ground. I had a good day today, look at that.'"



2002 Thunderbird, parts by Budd

"IT'S A DYING TRADE," HE SAID. "WHEN WE'RE GONE, YOU'RE NOT GONNA FIND A GOOD RIGGER, YOU'RE NOT GONNA FIND A GOOD WELDER, YOU'RE NOT GONNA FIND A GOOD MACHINIST. NOBODY WANTS TO DO IT ANYMORE"

It was raining outside the morning they started to remove the crown of the first press on the 16-line, which meant that it was raining inside as well, with water dripping down through the holes in the roof. The plant exaggerated whatever the external conditions, making warm weather hot, cool temperatures cold, and converting humid conditions outside into the primordial soup inside.

I'd told Matt the day before that I'd be in around 7:30 in the morning to see the crown of 16-1 come down. How long would it take? "If everything goes real well, two hours," he said.

It took longer than that simply to set up. It was a Sunday morning, and I wandered around the plant to kill time. I'd long since learned not to kick any of the junk—bolts, nuts, screws, bits of this and that—with which the shop floor was cluttered. You found that items that looked light didn't budge when nudged by the end of your foot. Without boots, you'd have had a badly stubbed toe, if not a broken metatarsal. I kicked bolts that felt like fifty-pound dumbbells. After a time, you learned to step over and around most everything.

On one of my wanderings, I'd picked up a discarded set of

CLOCKWISE FROM TOP: PAUL CLEMENS; WALTER P. REUTHER LIBRARY/WAYNE STATE UNIVERSITY; ARTHUR S. SIEGEL/LIBRARY OF CONGRESS; GETTY IMAGES

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The Budd foundry in 1967 (left); machine operators on lunch break, 1943 (right)

"commitments" signed by the twenty-five Budd Detroit press shop workers who had been part of the 16-line "natural working group." In the Budd cafeteria there was a ThyssenKrupp poster—"Natural Work Groups: The Power to Secure Our Future"—that showed all hands in, as in a football huddle.

Framed as a set, the four 16-line "commitments" were signed by all twenty-five members of the natural working group. The commitments were to "Group Purpose," "Vision," "Goals and Objectives," and "Standards/Norms/Expectations."

I'd sometimes snatch up a stray bit of company correspondence from the plant floor and read what I could stomach. From the *Handbuch* "THYSSENKRUPP BEST:" "Against the background of a visibly weakening world economy. ... It is vital to identify internal value-adding potential. ... The success of 'ThyssenKrupp best' is very much in the interests of the workforce: only a successful company can offer its employees secure and challenging jobs with good prospects."

Outside the press shop's bay door, red Cassens Transport trucks drove up Conner Avenue, carrying Jeep Cherokees and Jeep Commanders from Jefferson North Assembly to the Ford Freeway and, from there, to Chrysler dealer showrooms. It was nice to remember that some plants, for the time being, were still producing.

Budd, by contrast, was just about ready to begin some serious disassembling. To make the lift, the crew had "trucked the gantry up from Sandusky," Matt said, referring to the Tower Automotive plant in Upper Sandusky, Ohio, that a splinter crew was taking the presses out of. A four-hundred-ton lift system with four hydraulic "legs" that looked like large jack stands and functioned like powerful floor jacks, the gantry would be going back to Ohio the next day.

"It's like working for the carnival," Jeff said. "Set it up, tear it down. Set it up, tear it down."

Working with Matt and Jeff were Nedzad, a Bosnian, and Z., a black woman who left the crew shortly thereafter. The fifth member of the heavy-lift team was a guy named Guy. Matt said that Guy had worked in the "press shop in the Rouge"—the storied Ford Rouge plant—and that "though he doesn't know much about rigging"—there was a "yet" implied—"he knows his way around a press shop like nobody else."

One of the bigger presses in the Budd plant, 16-1 was a Danly QDC D4-2000-180-108. Twenty-six feet tall, it weighed around a million pounds. About 400,000 of those pounds were in the crown, but that figure had been reduced by 75,000 since they'd taken "some s--t off" in preparation for the lift, Matt said.

Two beams—the "headers"—ran across the crown lengthwise and rested on the gantries' pads. Two more beams, atop the others, crossed the crown widthwise, forming a rectangle, for what Matt called a "box lift." The gantry then pushed the beams and, with them, the crown up from below, in what resembled an industrial bench press.

The crowns of all of the presses in 16-line were lifted with the gantry. Matt assumed, however, that about two-thirds of the crowns in the press shop were small enough to lift with an overhead crane. Lifts with overhead cranes were less dramatic: they pulled the crown up with a set of spreader chains and suspended it in midair before moving it this way and that. The crane looked like an industrial Geppetto pulling a heavy puppet's strings.

To hear Matt tell it, disassembling a press and taking it down just wasn't that difficult, however it was done. Take care of the electrical, the plumbing, and a bunch of other tedious stuff, and then "you just start unstacking it," Matt said. "You pull the crown off. You pull the ram next. You pull or drop the side columns. You pull the bolster. You pull the base." And, just like that, a million pounds of press was on a truck, bound for central Mexico.

The lift of the crown of 16-1 would begin this heavy rigging process. Tape measures ran from the base of the lengthwise beams down to the gantry legs below. During the crown's slow descent, the crew constantly checked the tapes to see that all four sides were level.

"It's a game of inches," Jeff said to me.

Six hours after they started—and two months and a day after work on the line began—the crown of 16-1 was down, setting securely on blocks. Jeff brought out a case of beer to celebrate. The first big slab of Budd's industrial Stonehenge had come back to earth, bound for south of the border. B

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FOR THOSE WHO'VE ALWAYS BEEN FIRST IN LINE TO BUY OUR PRODUCTS. YOU DESERVE A BETTER SPOT.

You were the first in line and the first to tell everyone what you thought. You paid for and navigated through version 1.0 and beyond. It's time for your influence to be recognized. We've created a membership that pays you back for all that you've done. Introducing the Tech Enthusiast membership. For the first time individuals can join the Consumer Electronics Association (CEA)®. As a member you'll be involved in beta testing, receive special offers and be the first to preview products. Join. Because you belong ahead of the first person in line.

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The world's most normal cult
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Haute Scarves & Toastmasters & CEO Biology

Etc.



Finally, an office with its own arcade
Page 108



Love in the Time of Cupertino

More than 27,000 amorous iPhone devotees seek their match on Cupidtino.com, the Apple-lovers-only dating site. *By Gillian Reagan*

PHOTO ILLUSTRATION BY PETER CROWTHER ASSOCIATES; MOVIE STILL: EVERETT COLLECTION; TOP PHOTOGRAPH BY CHRIS MUELLER

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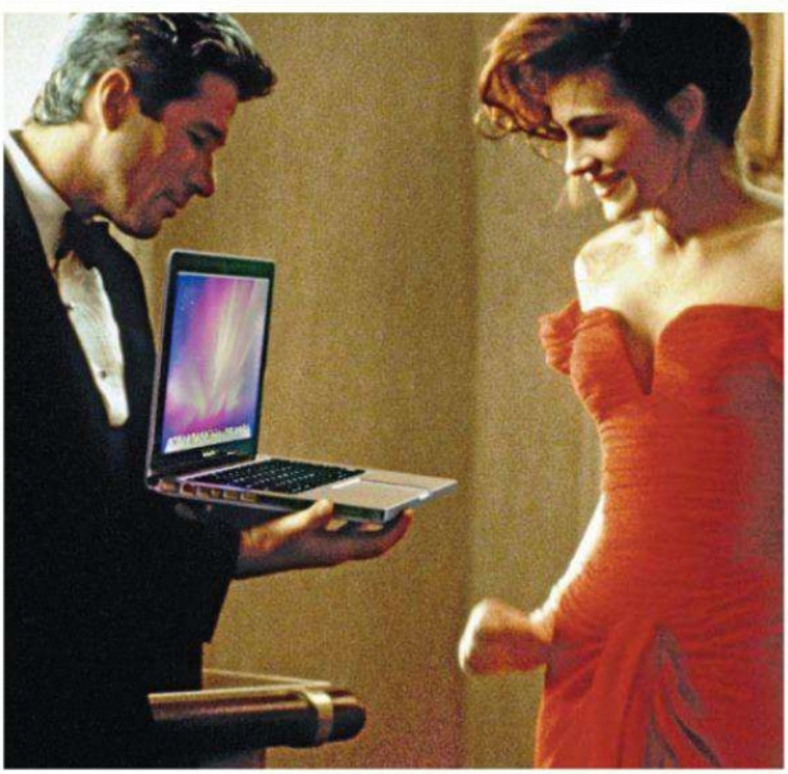
Etc. Cupidtino

Mel Sampat's girlfriend was getting jealous of his iPhone. Once a Microsoft program manager loyal to his company's wares, Sampat left his job last February and became an Apple convert, buying a veritable catalogue of products–iPhone, MacBook, Nano. By early April, his new fetish had become contentious. At their dinner table in San Francisco, Sampat's girlfriend would complain he was too busy playing with his gadgets to pay attention to her. "Can't we talk about us?" Sampat recalls her saying. "Can't we talk about *Desperate Housewives*?"

As their bickering escalated, Sampat, 31, reached a breaking point. "I said, 'Maybe I'll date someone who will talk to me about Apple stuff.' " As he left the room to cool off, Sampat had an epiphany: Was there a woman out there with whom he could share his love of Apple products? Someone to make iTunes playlists for, someone to watch him play Angry Birds on his iPhone? In that moment, Sampat conceived a matchmaking site specifically for amorous fans of the company headquartered in Cupertino, Calif. "I didn't wait around for market research or some consultant to tell me if it was going to work or not," he says. And so Cupidtino was born.

Sampat launched the site later that month, a few days after Apple Chief Executive Officer Steve Jobs unveiled the iPad. With Mac lust spreading all over the digital grid, Sampat e-mailed the link to a few tech blogs. One recipient was Michael Arrington, the influential Silicon Valley blogger, who was immediately moved to post an alarmed note on his site TechCrunch. "The thought of them breeding and creating little Apple fans, a whole family of hard core hipster Apple lovers, is just not a good thing," Arrington wrote. "On the other hand, making sure that Apple fans only date other Apple fans is a good way of stopping them from spreading their Apple fan genes to the general population, I guess. So maybe this site isn't all bad." A day after the launch, more than 5,000 users had signed up. Sampat's girlfriend learned of the site's existence by watching him discuss it on the local news.

"I couldn't think of a less important thing for couples than a mutual love of Apple products"



In less than a year, Cupidtino has grown to more than 27,000 registered "Machearts"–all of whom must sign up through the Apple-created browser Safari. The site's simple interface resembles a Mac desktop, with icons for favorites, gadgets, and messages hovering over a toolbar at the bottom of the screen. Users can name their favorite iTunes songs and display their favorite iPhone apps. They are prompted to fill out a form that asks both typical dating-site background questions such as "What do you do for a living?" and more specific ones like "When did you become 'a Mac'?" The site doesn't hide its premise. "Diehard Mac & Apple fans often have a lot in common," it declares on its home page, "personalities, creative professions, a similar sense of style and aesthetics, taste, and a love for technology. We believe these are enough fundamental reasons for two people to meet and fall in love."

While Cupidtino keeps its demographics private, a perusal of the site reveals that users tend to be male and largely West Coast-based–some of whom gamely pose with their favorite gadgets. While users can send initial messages for free, they will be prompted to pay $4.79 per month if they get a reply. The price is pegged to the cost of a Starbucks venti latte. "When Starbucks raises their prices, we'll raise ours," says Sampat. "That's how we adjust for inflation."

He won't reveal how many Machearts have paid for the service but claims the site, which Sampat runs with the help of two interns, makes a small profit. Cupidtino rents shared office space in San Francisco's Dogpatch neighborhood, but Sampat prefers to work from a café or even his bedroom. Cupidtino does not yet accept advertising, and Sampat and a partner–who remains anonymous to maintain his programming job at a major e-commerce company–are paying themselves modest salaries.

With more than 20 million Americans using some 1,500 dating networks, according to market research firm IBISWorld, Cupidtino is seeking venture capital funding to remain competitive. Sampat is considering a variety of partnerships and remains hopeful, particularly since Cupidtino is a digital province of highly attractive customers–at least demographically. Apple users are typically wealthier and willing to pay a price for higher quality, according to Leander Kahney, author of *Cult of Mac*. "If you use an Apple machine, then it does indicate some kind of person-

THIS PAGE: PHOTO ILLUSTRATION BY PETER CROWTHER ASSOCIATES; MOVIE STILL: EVERETT COLLECTION; OPPOSITE PAGE: ILLUSTRATIONS BY QUICKHONEY

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ality trait: creativity and independence, freedom of thought," he says. "It's a lifestyle indication, like the way you dress or the kind of haircut you have."

Of course, matching his and hers iPads do not guarantee eternal bliss. Lindsey Arasmith, a 25-year-old student in Sunnyvale, Calif., joined the site in April. "I had been on a string of bad dates, and I was ready to try something new," she says. Arasmith gave herself the handle "mostmac gal" on Cupidtino and quickly had one of the site's most viewed profiles. While browsing around, she found Chris Caselas, a 23-year-old Web developer. He lived in the Bay Area, liked the same music as she did, and was cute in that dweeby hipster kind of way. He also had a mustache.

The two chatted a bit online before making a plan in August. "I was completely comfortable with him before the date," says Arasmith. They met at a Roseville (Calif.) mall, where they caught a showing of the sci-fi thriller *Inception* and eventually ended at a local bar. "We really hit it off," she remembers. "The mutual love for our iPhones was the start." Although a full-blown romance did not materialize, the two remain friends.

Andrew Bayroff, a 38-year-old graphic designer from New York, also tried his hand at iLove this summer. "It was a nice time," he says of his one date with a Cupidtino user, "but there was no clicking, if you will." Despite owning 15 Apple products, Bayroff remains skeptical about his chances at long-term romance based on a shared interest in tech products. "In some circles it could be looked at as highly pathetic," he says. Professional dating coach Evan Marc Katz, a self-described "personal trainer for love," agrees. "I couldn't think of a less important thing for couples," he says, "than mutual love of Apple products." While Sampat says he's unaware of any marriages sparked by Cupidtino, he sees nearer-term rewards. "We don't make any promises," he says. "If you get a date out of it, you're luckier than most geeks."

Fortunately for Sampat, he has the best of both worlds. He still lives with the same girlfriend and remains deeply in love with his iPhone. "As soon as I started using Apple products, I realized what I was missing my whole life," he waxes. "I lost a few friends and obviously I can never work at Microsoft again, but that's O.K."

Hoping to expand its reach, Cupidtino is planning a new feature called Mac Her, which sends a short note to a crush. An iPhone app is also in the works. Meanwhile, the company is looking for investors. "It's not making us millionaires," Sampat says of his site, "but we can pay our salaries." While Apple has yet to officially acknowledge the site—and did not return messages for comment—Sampat says he feels good just being part of a larger cult. Whether or not the dating site makes him rich, he says, "I'll never sway my loyalty." He's talking about his iPhone, of course, not his girlfriend. Ⓑ

The Lonely Hearts Clubs

In the Internet Age, there's a dating site for everyone. —*Jilly Gagnon*



Farmers Only

FarmersOnly.com targets farmers, rural dwellers, and country folk whose interests include crops and livestock. Full-blown membership rates start at $15 per month. Midwestern founder Jerry Miller says his site, which is built around homespun values, has tallied more than 150,000 members and spawned 1,000 marriages since 2005.



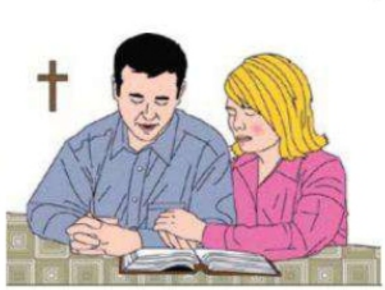
The Ugly Bug Ball

If you're an ugly seeking an ugly, then TheUglyBugBall.com (TUBB) is for you. Since Howard James founded the U.K.-based site in August 2010, more than 63,000 self-proclaimed "aesthetically challenged" people have signed up worldwide. TUBB charges a $19.95-per-month, all-access fee. The site celebrated its first engagement in October.



Beautiful People

BeautifulPeople.com's $19.95 monthly fee allows users—admitted based on their looks—to interact with its 700,000 global members. The site, launched by Greg Hodge and Robert Hintze in 2002, has generated more than 500 hottie marriages and 300 good-looking babies. It also has cut around 5,000 members who packed on pounds around the holidays.



We Waited

In keeping with the site's religious orientation, WeWaited.com screens to ensure that its more than 4,400 members are virgins. Founded by Christians Lety and Jose Colin, a couple who waited until their own marriage, less than a third of applicants are approved for "standard membership." The site also encourages members to connect on Second Life.



Geek to Geek

Nerds and dorks need love, too, and according to Chicago-based GK2GK.com, preferably from their own kind. Using its own special matching system, the Web destination caters exclusively to geek interests, which the site claims "just aren't the same as most people's." So far, founder Spencer Koppel's formula has drawn 200,000 self-declared geeks.



Gothic Match

If your turn-ons are dressing in period-stye clothing and listening to The Cure, GothicMatch.com is the place for you. Members pay upwards of $15.95 per month for access to forums about death and vampires. Its parent site, SuccessfulMatch.com, also hosts such sites as CougarMingle.com, BikerKiss.com, and TallFriends.com.

Etc. Perks

How to Be A Player

At EA's campus in Canada, gaming is serious business

Professional video game developers don't have typical day jobs. At Electronic Arts, one of the world's largest game makers, ergonomic chairs are replaced by La-Z-Boys, the library is stocked with games, and employees test their products in labs that mimic dorm rooms. The company, which employs 8,000 workers in more than 20 countries, is based in Redwood City, Calif. Its campus in Burnaby, B.C., near Vancouver, houses its largest development studio, however, and has produced some of the biggest video games ever, including the $2.5 billion revenue-generating FIFA Soccer franchise. Although developers pull grueling hours, EA ensures its employees don't travel far to play street hockey—or get a Shiatsu massage. B —*Jessica Flint*

The Perks

1. Pet-Friendly
Employees are encouraged to bring pets to work. Even rabbits are invited to camp out at at their owners' desks

2. Sports Leagues
Workday intramurals take place indoors on the basketball court, as well as outdoors on the soccer field and basketball and beach volleyball courts

3. Gaming
Developers get to test their games in homelike setups. The campus also has arcades with pinball, pool, Ping-Pong, and various gaming consoles

4. Library
The Information Resource Center stocks the latest video games, movies, books, magazines, and consoles that workers borrow for free

5. Cafeteria
The smaller of the two campus cafeterias, the Think Tank, doubles as a lounge area and meeting space. The main cafeteria offers stir-fry, burgers, salads, pizza, and pasta

6. Gym
Workers have free access to the campus gym, with treadmills, ellipticals, and weights. Group fitness classes are popular—as are on-site massages and physiotherapy

1



Thirty to 40 workers bring dogs to the office daily. Others do so sporadically

2



3



Gaming areas feel just like home. (Regular desks and chairs are aplenty, too)

4



The library has more than 40,000 catalogued items

Employees can also purchase video games at the campus store for $20

More Perks: A barber visits the campus weekly ▶ A tailor is available every two weeks ▶ On-site car washing and detailing ▶ Employes are given the

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The suburban Burnaby (B.C.) campus has three buildings on 450,000 square feet



Pro athletes that star in EA's games often stop by

Jerseys aren't restricted to rec leagues: The campus dress code is casual

5



Next to the Think Tank is an arcade where employees play EA titles–and old-school favorites such as Pac-Man

In addition to two cafeterias, the campus features two Starbucks cafés

6



An on-site gym gives employees the option to work out during the day

Classes include spinning, Pilates, boot camps, and weights

PHOTOGRAPHS BY CHRIS MUELLER FOR BLOOMBERG BUSINESSWEEK (6)

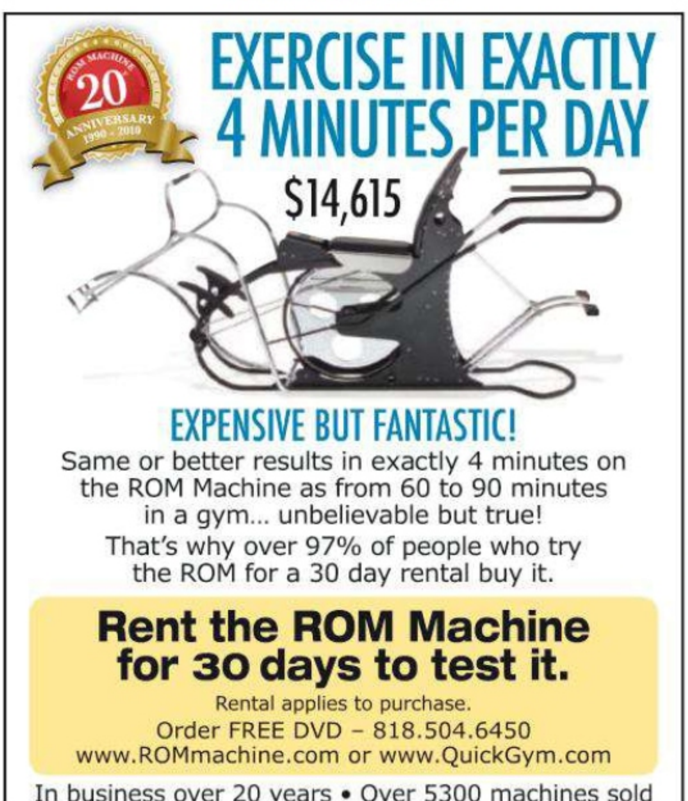
equivalent of six free games per year ▶ A large theater for family movie nights and watching live sports ▶ Discounts for movie tickets, ski passes, and more

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Private Vault



Exercise Equipment



PajamaGram



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Etc. One True Thing

The Office Shawl



Fight the cold by bundling up in your cube with Lord & Taylor's 100 percent cashmere wrap

The Want: A shawl you can keep in your drawer for when the weather–or the AC–acts up. It should be soft, medium-weight, and a neutral color that matches any outfit. No girly prints, please.

The Get: Lord & Taylor's Cashmere Wrap ($79.99). This cover-up will go with everything in your office wardrobe, from a blazer to jeans. It's wide and long enough to wrap in a variety of artful ways–or you can just throw it over your lap like a blanket. It's also elegant enough to cover your bare shoulders when you're decked out for a splashy after-work cocktail party. Ⓑ —*Meredith Stebbins*

LEGENDS OF THE SHAWL

Four simple, office-friendly ways to wear your wrap



The Supervisor Sling

Drape the shawl around your neck with the ends hanging down. You can wear the shawl just like this, or you can keep one end at one-third length and wrap the long end around your neck once.



The Boardroom Braid

Fold the shawl in half lengthwise, forming a loop. Wrap the shawl around your neck by pulling one end through the loop. Twist the loop to create a second loop. Pull the second end through the second loop.



The Corner Office Cowboy

Fold the shawl in half lengthwise. Fold it in half again diagonally. Now it will look like a handkerchief. With the triangle in front, wrap the ends around your neck, then tuck them underneath the fabric in front.



The Head Honcho Hitch

Drape the shawl around your neck. Take one end of the scarf and make a loose knot about halfway up. Take the other end of the scarf and pull it over and through the knot. Adjust by tightening the knot.

PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK; ILLUSTRATIONS BY CHRIS GASH

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Toastmasters love certificates ...



A fledgling Toastmaster speaking last fall in New York City





... and trophies ...

Making Every Word Count

By helping workers find their inner voices, Toastmasters has become a behemoth. *By Joel Stein*

The 1,500 people walking around the Desert Springs Marriott appear as diverse as the Pitt-Jolie family. Yet despite being of both genders and of every age and race, they all seem like old, white insurance salesmen. They're confident, friendly, and wearing boxy blazers affixed with thick, plastic name badges. And they're probably not people the Pitt-Jolie family would hang out with.

They gathered in Palm Desert, Calif., last August for the annual Toastmasters International Convention. While Toastmasters has been teaching people how to improve their public speaking since 1924, the nonprofit started aggressively pushing for international growth when Daniel Rex became executive director in 2008. The 250,000-member organization now adds global Toastmasters at about 10 percent per year. (Much of the growth comes from India and Sri Lanka, places where people want to learn business skills—and English.) This month, Toastmasters begins its 2011 International Speech Contest in which 38,000 contestants from 113 countries compete for the chance to walk around a hotel next summer in a boxy suit and name tag—and the title of World Champion of Public Speaking.

"There was that Chris Farley motivational speaker on *Saturday Night Live.* That's not what we do!"

Toastmastering has gone from a small-town pastime for shy groomsmen to a globalized business finishing school. While Toastmasters still has a base in small towns, 60 percent of its clubs are now in corporations. There are toastmaster clubs at Bank of America, Caterpillar, Intel, Microsoft, and Wells Fargo. Aspiring rhetoricians—typically in their late 20s and early 30s—join because they're looking to enhance their career prospects. "There was that Chris Farley motivational speaker on *Saturday Night Live*," says Rex referring to a dark moment in the annals of speechifying. "That's not what we do! We help the new supervisor who just got promoted and doesn't feel comfortable talking to the five people working for him. We teach people skills, but what we really teach is confidence."

Experienced Toastmasters do tend to be confident. They also tend to have run across a country or sailed across an ocean—and are extremely happy to speak about it for five to seven minutes. John Rich, who teaches "communication leadership skills" Toastmaster classes at companies such as IBM and Bell Canada, wears a kilt, it seems, just so he can speak about it.

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Each seven-and-a-half minute speech should be broken down into simple points







... in order to win



... and aren't afraid to act out their speeches ...

PHOTOGRAPHS BY ANDREW HETHERINGTON FOR BLOOMBERG BUSINESSWEEK

As Rich explains, for about five minutes, his dress code was inspired by the Canadian National Guard's Scottish division. "I branded myself," says Rich, who has cycled across Canada. "That's what Toastmasters needs to do. So people stop saying, 'Are you a drinking club? Do you make toasters?'"

Perception problems may exist because of Toastmasters' unique organizational structure. There are only 90 Toastmasters employees around the world, partly because so much work is done by volunteers. Members are required to make all sales calls to human resources departments as part of their "leadership development." This multitasking quirk, along with a complex membership hierarchy (from Competent Leader to Distinguished Toastmaster) and a raft of soberly titled booklets (*Building Your Thinking Power, Part 1*, *Building Your Thinking Power, Part 2*), makes Toastmasters seem like a self-help cult for the exceedingly normal. However, with membership at about $20 a year, and many booklets costing $5, if it's a scam, it's a scam run by an awful businessman.

Toastmasters also tend to be exceedingly nonjudgmental. A seminar called "Finding Your Voice" in the 300-plus seat auditorium of the Desert Springs Marriott is standing-room-only. And the audience laughs at everything. When speaker Lance Miller asks, "Anybody seen *City Slickers*?" people actually raise their hands. When he holds up a bottle of water and asks, "What can you tell me about this bottle of water?" he receives more than 50 different responses. These range from the obvious ("It's liquid") and the slightly less obvious ("It can put out fires") to the scientific ("Chemically, it's made of two gases") and even the metaphysical ("There would be no swimming, no skiing, no rafting without water.")

The 250,000-member nonprofit seems like a self-help cult for the exceedingly normal

The banner event is the International Speech Contest, which has been held since 1938 and remains the WrestleMania of public speaking. Every Toastmaster invited has earned entry by winning his or her local district's competition with a speech no longer than 7 minutes and 30 seconds. While there is no financial reward for victory, the honor bestows bragging rights—and some spin-off financial opportunities. The Susan Lucci of public speakers, Miller lost for 12 consecutive years before winning the contest in 2005 with a speech about validation (both parking and spiritual). He's now confident that there isn't anything he can't wax about for under seven-and-a-half minutes. "I can do a speech about a can of Coke," says Miller, who has sailed the Atlantic and run across Europe. "I can do a speech about a collapsing arm on a piece of luggage." At the end of his speech, he sells $2,394 worth of his instructional DVDs in less than a half an hour.

According to Miller, a speech is like a dance: A good speaker signals where he wants to go, and never dips too early. "The power is in the simplicity and directness," he says. He warns students not to quote famous people—a flaw of many speeches at the competition. "He's using the quote to state something he doesn't feel capable of saying," says Miller of one contestant. "He just brought the person he was quoting to the stage and said, 'You're a bigger authority.'" The contestant was quoting Abraham Lincoln.

All the contestants tell their stories with dramatic pauses, talking to invisible characters and gesturing like magicians. One guy slaps his butt and gallops when comparing job interviews to riding a horse. Another speech is titled "The Magic of Unconditional Love" and is actually about the magic of unconditional love. Another guy talks about his divorce a lot. Toastmasters rewards many of them with trophies and certificates.

Rory Vaden, a young guy in a boxy suit with a pocket square, is a 2007 World Champion of Public Speaking runner-up. He suggests that aspiring business leaders "hologram" the stage. "When you walk between places to tell different stories, it creates a physical transition that helps the audience," he says. Vaden, who leveraged his speechifying celebrity into a book, *No Laughs to Know Laughs*, is an advocate of the rule of threes, in which you list two items as the setup and use the third as a punch line. As in: Vaden is well dressed, an author, and currently climbing the stairs of the world's tallest buildings. He's also happy to talk about it. B

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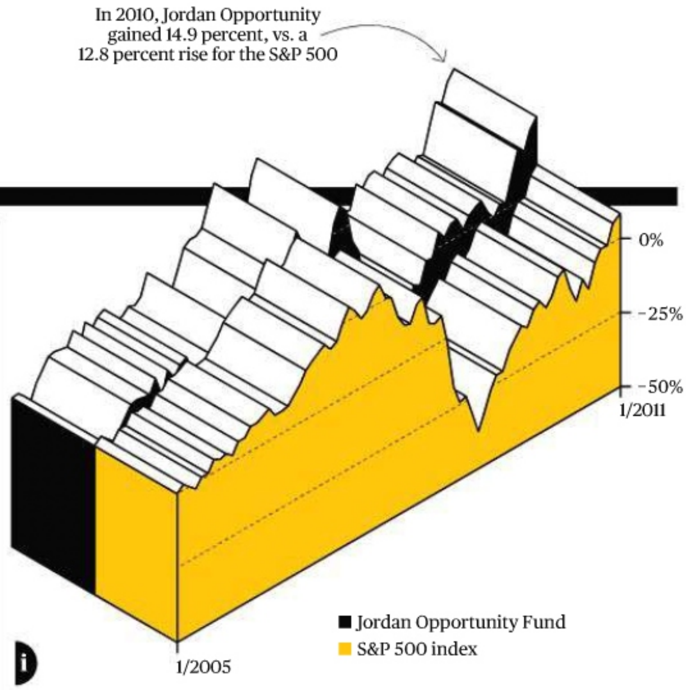
Etc. Wealth

Variations on an Investment Theme

Jerry Jordan looks for major economic trends such as global food shortages and increasing demand for tablet PCs

We are an all-cap growth mutual fund but tend to migrate toward mid- and large-cap stocks. To differentiate ourselves, we are thematic investors. We try to find four to six themes that we think have a 12- to 24-month time horizon. Then we invest in three to five names in that theme, so the portfolio is generally made up of 25 to 45 stocks, and we manage the holdings around those themes. If we have five stocks in a theme, and the average price of those stocks rises from $40 to $60, we may take some money off the table. Part of our investment process is trying to trade around the ebbs and flows that any group of stocks will inevitably have. We often look at a stock's valuation relative to its own history. If I get nervous about the stock market, I can buy put options to protect the fund. In 2008 that helped a lot. Ⓑ

—As told to Lewis Braham



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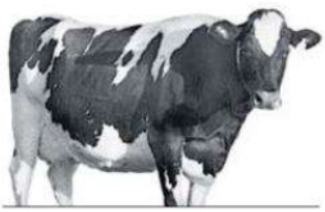
Boston's Hellman Jordan Management oversees $600 million. Jordan Opportunity's 6.6 percent five-year annualized return beat the S&P 500's 2.2 percent return and 95 percent of its large-cap growth peers

Jordan on his picks



1. United Continental Holdings

I believe the airline industry in the next 10 years is going to be a less cyclical and more profitable business than it has been in the last 20 years. United is very cheap. It's $24, and I think it could reach $35 or $40 in 2011. It trades at just six times 2010's earning estimates—low for its history and about a 50 percent discount to the airline sector. The company has already been through a bankruptcy, so it doesn't have the same union or pension issues that its competitors have.



2. Mosaic

Mosaic is one of a handful of suppliers of concentrated phosphate and potash fertilizer. This oligopoly will maintain pricing at a time when the world needs to start spending a huge amount to produce grain more efficiently. Growth in emerging markets means we've got 500 million more people in the middle class now vs. one decade ago. They'll require more food. Mosaic's probably trading at 11 or 12 times estimated 2011 earnings—slightly less than its peers.



3. SanDisk

As a maker of flash memory microchips, SanDisk is a play on smartphones and tablet PCs. What I like is that I don't have to try to pick the winner of the tablet PC or smartphone race. Maybe it will be Apple, maybe it won't. But these devices all have flash memory in them. SanDisk trades at 13 to 14 times 2011 consensus earnings estimates of $3.81 per share. I think it will earn $6; by my estimate it trades at 8.5 times 2011 earnings. The company has almost never been this cheap.



4. Walt Disney

For 10 years the market has lauded companies such as Apple and Netflix that deliver media content in a stylish fashion while punishing people making the content. But nobody buys an iPod to listen to air. Content makers like Disney will start pulling back access and raising fees, which will be hugely positive to bottom lines. Disney trades at 15 times fiscal 2011 earnings. I can see it trading at 25 times a $3 per share earnings number in 2012—around where it's traded historically.

FROM LEFT: ALFRED GESCHEIDT/GETTY IMAGES; FRANK LUKASSECK/GETTY IMAGES; WALT DISNEY/EVERETT COLLECTION

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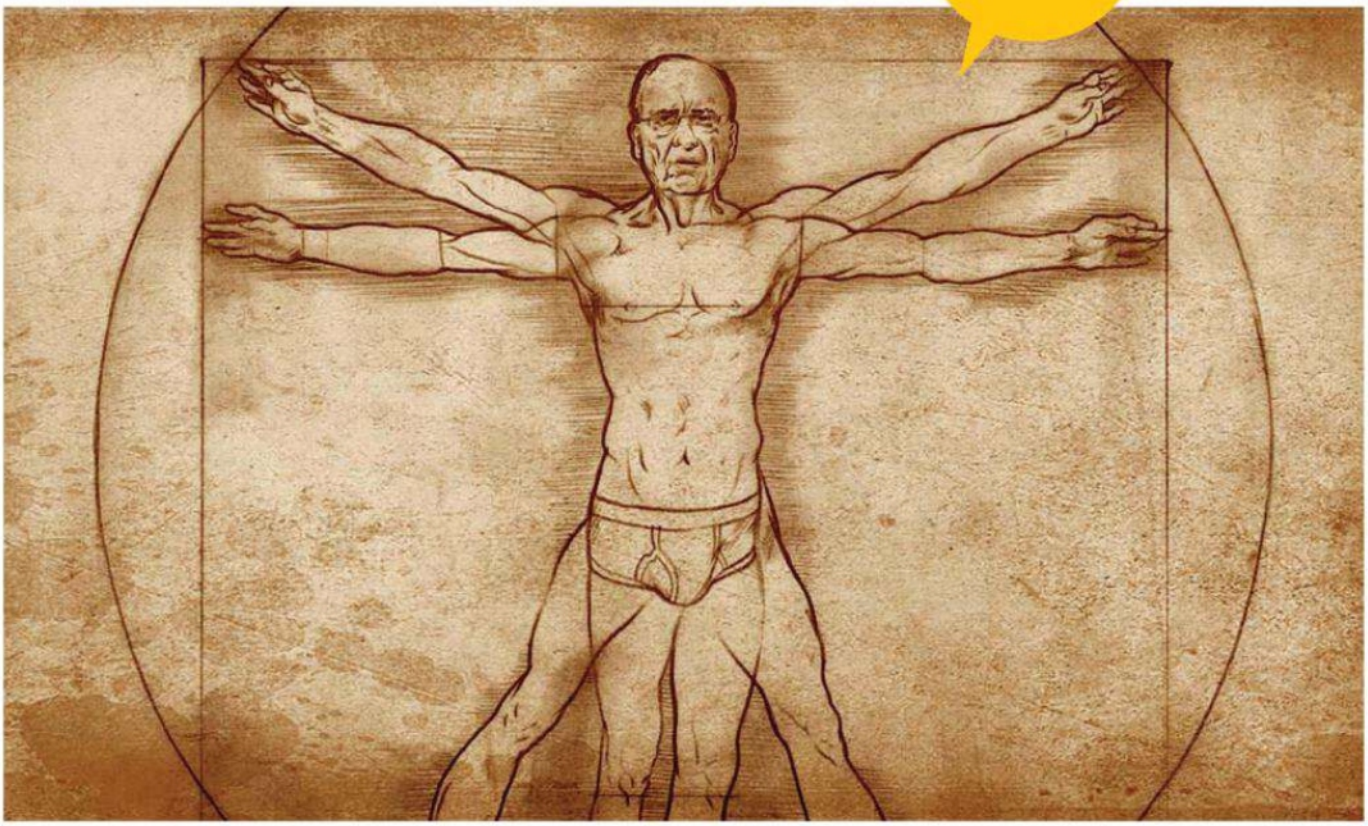
*Morningstar *FundInvestor*, June 2010. Morningstar evaluated the 30 largest fund groups (based on asset size) on the following measures: manager retention rates over the last 5 years; average fund management tenure (how long the portfolio managers have managed their funds); fund managers' investment in the funds they manage; 3-year asset-weighted performance of all share classes; and Morningstar Stewardship Grades, which evaluate a fund group's culture, fees, Boards of Directors, manager incentives, and regulatory records. Data used were as of 5/31/10 except for manager retention, which is through 12/31/09. **Morningstar made its selections based on low cost, a focus on investors' interests, consistent investment strategy, and fund manager experience. ©2010 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

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Surely, science and evolution can explain why moguls are made more perfectly than the rest of us



The Origin of C-Suites

How can the we explain the rise of the mogul class? Duh, it's evolution. *By Michael Rosenwald*

At long last, a book explaining why CEOs are intrinsically better than the rest of us! While shelves groan under the weight of leadership manifestos, Mark van Vugt and Anjana Ahuja deserve some credit for unleashing a Trojan Rabbit into this crowded genre. *Naturally Selected: The Evolutionary Science of Leadership* is a peculiar, sometimes interesting, sort of pseudoscientific, and often baffling explanation of how evolution has created a subspecies of men who grow tall, remarry constantly, and make oodles of money. If it's true, it might one day give Upper East Side divorce lawyers the same clout *The Origin of Species* gave biology teachers.

Van Vugt, a psychology professor at the VU University Amsterdam, and Ahuja, a former *Times of London* science writer, build their argument from numerous scientific, anthropological, historical, and biological studies. They trace the evolution of leadership back some 2 million years to the early Homo sapien ancestors pottering around the African savanna. "Throughout human evolutionary history," they write, "there has been an ongoing arms race between leaders and followers to gain the upper hand in the battle for power." And though we've come a long way in the intervening millennia, the authors contend that our instincts for following dynamic leaders remain primal. This basic assertion—the bulwark of their lecture circuit-ready Evolutionary Leadership Theory—is meant to explain away everything from Wall Street's fixation on Steve Jobs' health to why Rupert Murdoch, Jack Welch, and Larry Ellison have been married a combined 10 times.

According to *Naturally Selected*, these behaviors are all rooted in our ancestry. A leader's sickness, they claim, has always forced us to fear for the group he leads—particularly if its stock is trading at more than $300 per share. Historically, as men grow ever more powerful, the most evolved have attracted more babes. Based on studies of early African statesmen, the authors note, it's only to be expected that the richer our leaders become, "the age of women they liaise with drops (thus increasing their chances

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Naturally Selected: The Evolutionary Science of Leadership
By Mark van Vugt and Anjana Ahuja
HARPERBUSINESS
272 pp; $25.99

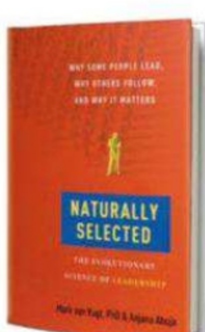


ILLUSTRATION BY JAMES CAREY

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of conceiving).” Finally, a thoughtful explanation of why J. Howard Marshall married Anna Nicole Smith.

The main premise of Evolutionary Leadership Theory is to root the complicated lives of modern business moguls in an historical context. Status, the authors argue, has always drawn people to their leaders. Yet over the years, the ability to wrestle an animal has been replaced with running a company. “And so,” the authors explain, “thanks to Evolutionary Leadership Theory, we have a thread linking money to power and to sex.”

Befitting our ancient behavior, corporations prefer entrusting their chief executive jobs to healthy studs, van Vugt and Ahuja contend. “In ancestral times, the only real selection process for aspiring leaders was through appearance and demeanor,” they write. “Every time you see an attractive person, that skipped heartbeat is evolution’s shorthand for saying they’ve got great genes and therefore any offspring you have stand a decent chance of survival.”

The authors also argue that such corporations cannot deny an ancestral urge to pick the taller candidate. Their statistics, at first, support this claim. In 2005 more than 30 percent of *Fortune* 500 CEOs stood 6’2’’ or taller, compared with 4 percent of the general U.S. population. The authors also note that with the exception of George W. Bush’s defeat of John Kerry, the taller candidate almost always wins the U.S. Presidency. Two million years ago, “a taller person would have been a more formidable warrior in hand-to-hand combat, and a better peacekeeper,” they write. Fittingly, Bush’s victory is explained with a Darwinian asterisk. Dubya looked more masculine—a quality favored during wartime.

Yet a host of contradictory evidence appears to have been overlooked. Blackstone CEO Steve Schwarzman—along with seemingly half of Wall Street and almost all of Hollywood—stands below six feet. As did a Corsican semi-dwarf who once nearly took over Europe. At 5’7’’, Welch, the former CEO of General Electric, might not make a middle school basketball team but was somehow one of the great corporate leaders of the late 20th century. Go figure.

The authors also gloss over the fact that every wartime President since James Madison has won reelection. Or that more than two dozen women now run *Fortune* 1000 companies—despite van Vugt and Ahuja’s assertion that “a woman wielding great power is still somehow seen as unnatural, especially if she is of childbearing age.” Unfortunately, explaining away a culture’s less acceptable habits remains a lucrative business proposition. The evolutionary arms race between leaders and followers has nothing on the race between publishers over gimmicks to sell leadership books. B

The CEO Alpha-O-Meter

An updated formula for assessing the Darwinian powers of today’s business moguls




Metrics	**Andrea Jung** *Chairman and CEO, Avon*		**Elon Musk** *Chairman and CEO, Tesla*	
Fancy Diploma	Princeton	1	Penn	1
Marriages	Two	2	Two	2
Children	Two	2	Five	5
200-Ft. Toy	Trademark pearl choker	0	Falcon 9 rocket (180 ft.)	0
Hair Factor	Plentiful	1	Thinning	0
Fictional Portrayal	None	0	Tony Stark in *Iron Man*	1
Extra Credit: Big Buddy	Patrick Dempsey	1	Sergey Brin and Larry Page	2
Total Score		7		11




Metrics	**Ronald Perelman** *Chairman and CEO, MacAdrews & Forbes*		**Larry Ellison** *CEO, Oracle*	
Fancy Diploma	Penn	1	U of Chicago dropout	0
Marriages	Four	4	Four	4
Children	Seven	7	Two	2
200-Ft. Toy	*C2* yacht (257 ft.)	1	*Rising Sun* yacht (452 ft., 8 in.)	2
Hair Factor	None	0	Leninist goatee	1
Fictional Portrayal	Ronnie Pearlyman in *Apartment 3-G*	1	None	0
Extra Credit: Big Buddy	Robert De Niro	1	Tony Blair	1
Total Score		15		10

JUNG: DIMITRIOS KAMBOURIS/WIREIMAGE FOR AVON; MUSK: KRISTIN CALLAHAN/ACEPIXS.COM/NEWSCOM; ELLISON: KIM KULISH/CORBIS; PERLMAN: MS4/ZUMA PRESS/NEWSCOM

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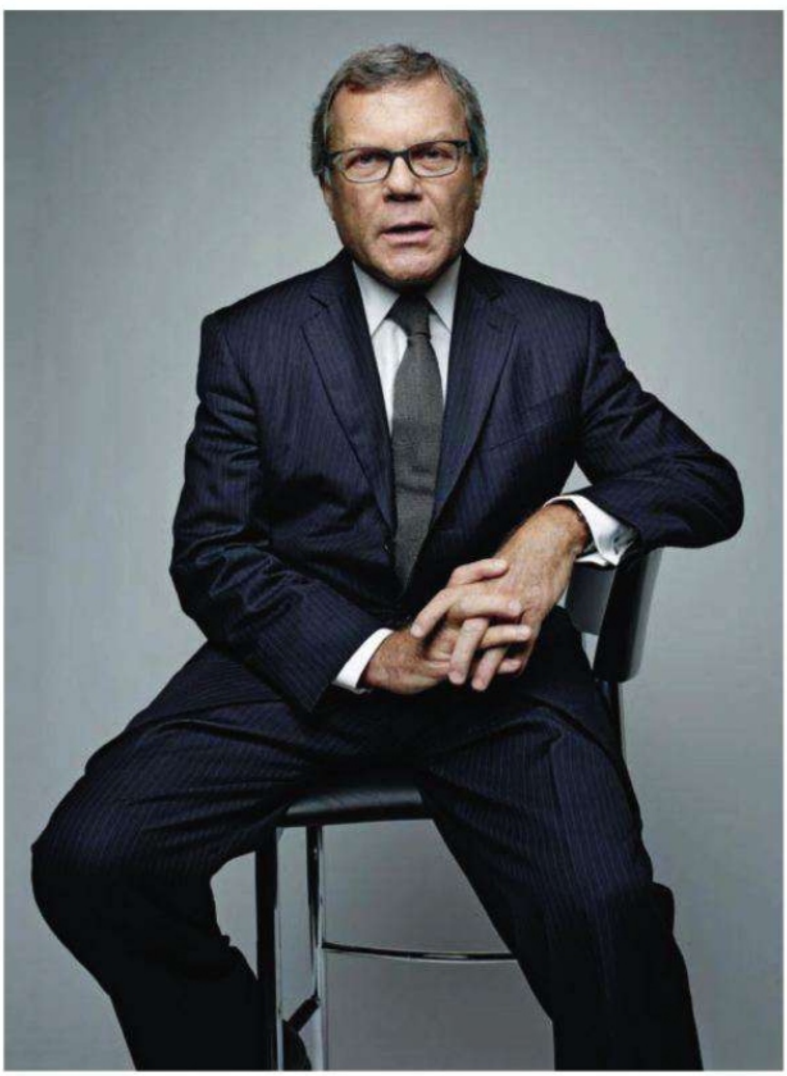
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Martin Sorrell

"It's hard to get everybody to play in the same sandbox. After an acquisition, some people don't want to be where they ended up"

The WPP CEO on building his advertising juggernaut, letting go of employees, and uniting the company after acquisitions



In 1985, I left Saatchi and invested in a small public company called WPP, eventually becoming chief executive officer. You might say my decision to leave was a form of male menopause. At 40, I hadn't started my own business so this felt like the last chance. About 18 months later, we purchased J. Walter Thompson, an advertising company 13 times our size. It was a hostile takeover. We paid $525 million. It was a no-brainer: I didn't have much, so I had nothing to lose.

As I've grown WPP, the toughest choices for me always come down to people. The hardest thing is letting them go. It's horrible. You hesitate to do it, and there are cases where I know I've waited too long. It's hard to get everybody to play in the same sandbox. After an acquisition, some people don't want to be where they ended up. We have acquired companies that used to be competitors—Ogilvy, Grey, and Y&R—and it's difficult for rivals to come together. The mindset shifts with the second generation, but until then it's a challenge. We can't be a collection of businesses. Clients expect us to connect the dots. The task is to get every one of the 140,000 people here to know what the other 139,999 are doing.

When we buy a company, we always think of it as buying the team. Advertising and communications is a people business. Of course, people are cyclical, and partners in a business can change—especially when they become wealthy. We spend about $9 billion annually on people, but we don't spend enough time evaluating that investment. The conventional wisdom in our business is if you need people, you poach them. The industry will not survive long term unless we change this attitude.

A founder has a different business perspective. WPP is highly personal to me. I've watched the bricks being put in the wall. Whoever does my job in the future will not do it the same way. I'm not saying they'll do it worse, but they won't have the same emotional attachment I've had. **B**

—As told to Diane Brady

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